DESCRIPTION OF THE TAX PROVISIONS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 3920, THE "TRADE AND GLOBALIZATION ASSISTANCE ACT OF 2007"

Scheduled for Markup
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HOUSE COMMITTEE ON WAYS AND MEANS
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INTRODUCTION

The House Committee on Ways & Means has scheduled a markup on October 24, 2007. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the tax provisions of the Chairman's amendment in the nature of a substitute to H.R. 3920, the Trade and Globalization Assistance Act of 2007.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Tax Provisions of the Chairman's Amendment in the Nature of a Substitute to H.R. 3920, the "Trade and Globalization Assistance Act of 2007,"* (JCX-102-07), October 23, 2007. This document can also be found on our website at www.house.gov/jct.

A. Modify the Health Coverage Tax Credit

Present Law

In general

Under the Trade Act of 2002,[2] in the case of taxpayers who are eligible individuals, a refundable tax credit is provided for 65 percent of the taxpayer's expenses for qualified health insurance of the taxpayer and qualifying family members for each eligible coverage month beginning in the taxable year. The credit is commonly referred to as the health coverage tax credit ("HCTC"). The credit is available only with respect to amounts paid by the taxpayer. The credit is available on an advance basis.

Qualifying family members are the taxpayer's spouse and any dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency exemption. Any individual who has other specified coverage is not a qualifying family member.

Persons eligible for the credit

Eligibility for the credit is determined on a monthly basis. In general, an eligible coverage month is any month if, as of the first day of the month, the taxpayer (1) is an eligible individual, (2) is covered by qualified health insurance, (3) does not have other specified coverage, and (4) is not imprisoned under Federal, State, or local authority.[3] In the case of a joint return, the eligibility requirements are met if at least one spouse satisfies the requirements.

An eligible individual is an individual who is (1) an eligible TAA recipient, (2) an eligible alternative TAA recipient, or (3) an eligible Pension Benefit Guaranty Corporation ("PBGC") pension recipient.

An individual is an eligible TAA recipient during any month if the individual (1) is receiving for any day of such month a trade readjustment allowance[4] or who would be eligible to receive such an allowance but for the requirement that the individual exhaust unemployment benefits before being eligible to receive an allowance and (2) with respect to such allowance, is covered under a certification issued under subchapter A or D of chapter 2 of title II of the Trade Act of 1974. An individual is treated as an eligible TAA recipient during the first month that such individual would otherwise cease to be an eligible TAA recipient.

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[2] Pub. L. No. 107-210 (2002).

[3] An eligible month must begin after November 4, 2002. This date is 90 days after the date of enactment of the Trade Act of 2002, which was August 6, 2002.

[4] Part I of subchapter B, or subchapter D, of chapter 2 of title II of the Trade Act of 1974. Among other requirements, payment of a trade readjustment allowance is conditioned upon the individual enrolling in certain training programs or receiving a waiver of training requirements.

An individual is an eligible alternative TAA recipient during any month if the individual (1) is a worker described in section 246(a)(3)(B) of the Trade Act of 1974 who is participating in the program established under section 246(a)(1) of such Act, and (2) is receiving a benefit for such month under section 246(a)(2) of such Act. An individual is treated as an eligible alternative TAA recipient during the first month that such individual would otherwise cease to be an eligible TAA recipient.

An individual is a PBGC pension recipient for any month if he or she (1) is age 55 or over as of the first day of the month, and (2) is receiving a benefit any portion of which is paid by the PBGC. The IRS has interpreted the definition of PBGC pension recipient to also include certain alternative recipients and recipients who have received certain lump-sum payments on or after August 6, 2002.

An otherwise eligible taxpayer is not eligible for the credit for a month if, as of the first day of the month, the individual has other specified coverage. Other specified coverage is (1) coverage under any insurance which constitutes medical care (except for insurance substantially all of the coverage of which is for excepted benefits)[5] maintained by an employer (or former employer) if at least 50 percent of the cost of the coverage is paid by an employer[6] (or former employer) of the individual or his or her spouse or (2) coverage under certain governmental health programs. Specifically, an individual is not eligible for the credit if, as of the first day of the month, the individual is (1) entitled to benefits under Medicare Part A, enrolled in Medicare Part B, or enrolled in Medicaid or SCHIP, (2) enrolled in a health benefits plan under the Federal Employees Health Benefit Plan, or (3) entitled to receive benefits under chapter 55 of title 10 of the United States Code (relating to military personnel). An individual is not considered to be enrolled in Medicaid solely by reason of receiving immunizations.

A person is not an eligible individual if he or she may be claimed as a dependent on another person's tax return. A special rule applies with respect to alternative TAA recipients. For eligible alternative TAA recipients, an individual has other specified coverage if the individual is (1) eligible for coverage under any qualified health insurance (other than coverage

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[5] Excepted benefits are: (1) coverage only for accident or disability income or any combination thereof; (2) coverage issued as a supplement to liability insurance; (3) liability insurance, including general liability insurance and automobile liability insurance; (4) worker's compensation or similar insurance; (5) automobile medical payment insurance; (6) credit-only insurance; (7) coverage for on-site medical clinics; (8) other insurance coverage similar to the coverages in (1)-(7) specified in regulations under which benefits for medical care are secondary or incidental to other insurance benefits; (9) limited scope dental or vision benefits; (10) benefits for long-term care, nursing home care, home health care, community-based care, or any combination thereof; and (11) other benefits similar to those in (9) and (10) as specified in regulations; (12) coverage only for a specified disease or illness; (13) hospital indemnity or other fixed indemnity insurance; and (14) Medicare supplemental insurance.

[6] An amount is considered paid by the employer if it is excludable from income. Thus, for example, amounts paid for health coverage on a salary reduction basis under an employer plan are considered paid by the employer. A rule aggregating plans of the same employer applies in determining whether the employer pays at least 50 percent of the cost of coverage.

under a COBRA continuation provision, State-based continuation coverage, or coverage through certain State arrangements) under which at least 50 percent of the cost of coverage is paid or incurred by an employer of the taxpayer or the taxpayer's spouse or (2) covered under any such qualified health insurance under which any portion of the cost of coverage is paid or incurred by an employer of the taxpayer or the taxpayer's spouse.

Qualified health insurance

Qualified health insurance eligible for the credit is: (1) COBRA continuation coverage; (2) State-based continuation coverage provided by the State under a State law that requires such coverage; (3) coverage offered through a qualified State high risk pool; (4) coverage under a health insurance program offered to State employees or a comparable program; (5) coverage through an arrangement entered into by a State and a group health plan, an issuer of health insurance coverage, an administrator, or an employer; (6) coverage offered through a State arrangement with a private sector health care coverage purchasing pool; (7) coverage under a State-operated health plan that does not receive any Federal financial participation; (8) coverage under a group health plan that is available through the employment of the eligible individual's spouse; and (9) coverage under individual health insurance if the eligible individual was covered under individual health insurance during the entire 30-day period that ends on the date the individual became separated from the employment which qualified the individual for the TAA allowance, the benefit for an eligible alternative TAA recipient, or a pension benefit from the PBGC, whichever applies.[7]

Qualified health insurance does not include any State-based coverage (i.e., coverage described in (2)-(7) in the preceding paragraph), unless the State has elected to have such coverage treated as qualified health insurance and such coverage meets certain requirements.[8] Such State coverage must provide that each qualifying individual is guaranteed enrollment if the individual pays the premium for enrollment or provides a qualified health insurance costs eligibility certificate and pays the remainder of the premium. In addition, the State-based coverage cannot impose any pre-existing condition limitation with respect to qualifying individuals. State-based coverage cannot require a qualifying individual to pay a premium or contribution that is greater than the premium or contribution for a similarly situated individual who is not a qualified individual. Finally, benefits under the State-based coverage must be the same as (or substantially similar to) benefits provided to similarly situated individuals who are not qualifying individuals. A qualifying individual is an eligible individual who seeks to enroll in the State-based coverage and who has aggregate periods of creditable coverage[9] of three

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[7] For this purpose, "individual health insurance" means any insurance which constitutes medical care offered to individuals other than in connection with a group health plan. Such term does not include Federal- or State-based health insurance coverage.

[8] For guidance on how a State elects a health program to be qualified health insurance for purposes of the credit, see Rev. Proc. 2004-12, 2004-1 C.B. 528.

[9] Creditable coverage is determined under the Health Insurance Portability and Accountability Act. Sec. 9801(c).

months or longer, does not have other specified coverage, and who is not imprisoned. A qualifying individual also includes qualified family members of such an eligible individual.

Qualified health insurance does not include coverage under a flexible spending or similar arrangement or any insurance if substantially all of the coverage is for excepted benefits.

Other rules

Amounts taken into account in determining the credit may not be taken into account in determining the amount allowable under the itemized deduction for medical expenses or the deduction for health insurance expenses of self-employed individuals. Amounts distributed from a medical savings account or health savings accounts are not eligible for the credit. The amount of the credit available through filing a tax return is reduced by any credit received on an advance basis. Married taxpayers filing separate returns are eligible for the credit; however, if both spouses are eligible individuals and the spouses file separate returns, then the spouse of the taxpayer is not a qualifying family member.

The Secretary of the Treasury is authorized to prescribe such regulations and other guidance as may be necessary or appropriate to carry out the provision.

Health Insurance Portability and Accountability Act of 1996

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") imposes a number of requirements with respect to health coverage that are designed to provide protections to health plan participants. Among other things, HIPAA generally provides that a pre-existing condition exclusion may be imposed only if: (1) the exclusion relates to a condition (whether physical or mental), regardless of the cause of the condition, for which medical advice, diagnosis, care, or treatment was recommended or received within the 6-month period ending on the enrollment date; (2) the exclusion extends for a period of not more than 12 months after the enrollment date; and (3) the period of any pre-existing condition exclusion is reduced by the length of the aggregate of the periods of creditable coverage (if any) applicable to the participant as of the enrollment date. In general terms, creditable coverage includes health care coverage without a gap of more than 63 days. Special limitations to the preexisting condition exclusion rules apply in the case of newborns, adopted children, and pregnancy.

Description of Proposal

In general

The proposal sunsets the health coverage tax credit and makes several other modifications.

Increase in credit percentage amount

The proposal increases the amount of the credit to 85 percent of the taxpayer's expenses for qualified health insurance of the taxpayer and qualifying family members.

Elimination of training requirement for individuals receiving unemployment compensation

The proposal modifies the definition of an eligible TAA recipient to eliminate the requirement that an individual be enrolled in training in the case of an individual receiving unemployment compensation.

Eligibility made retroactive to TAA-related loss of employment

Under the proposal, in the case of an individual who is an eligible TAA recipient or eligible alternative TAA recipient for any month, such individual is treated as an eligible individual for any month preceding such month which begins after the later of (1) the date of separation from employment which gives rise to the individual being an eligible TAA recipient or eligible alternative TAA recipient, or (2) December 1, 2007.

Continued qualification of family members after certain events

The proposal provides continued eligibility for the credit for family members after certain events. The rule applies in the case of (1) the eligible individual becoming entitled to Medicare, (2) divorce and (3) death.

In the case of a month which would be an eligible coverage month with respect to an eligible individual except that the individual is entitled to benefits under Medicare Part A or enrolled in Medicare Part B, the month is treated as an eligible coverage month with respect to the individual solely for purposes of determining the amount of the credit with respect to qualifying family members (i.e., the credit is allowed for expenses paid for qualifying family members after the eligible individual is eligible for Medicare). Such treatment applies only with respect to the first 36 months after the eligible individual is first entitled to benefits under Medicare Part A or enrolled in Medicare Part B.

In the case of the finalization of a divorce between an eligible individual and the individual's spouse, the spouse is treated as an eligible individual for a period of 36 months beginning with the date of the finalization of the divorce. Under such rule, the only qualifying family members that may be taken into account with respect to the spouse are those individuals who were qualifying family members immediately before such divorce finalization.

In the case of the death of an eligible individual, the spouse of such individual (determined at the time of death) is treated as an eligible individual for a period of 36 months beginning with the date of death. Under such rule, the only qualifying family members that may be taken into account with respect to the spouse are those individuals who were qualifying family members immediately before such death. In addition, any individual who was a qualifying family member of the decedent immediately before such death[10] is treated as an eligible individual for a period of 36 months beginning with the date of death. In determining the amount of the credit, only such qualifying family member may be taken into account.

[10] In the case of a dependent, the rule applies to the taxpayer to whom the personal exemption deduction under section 151 is allowable.

Modification of creditable coverage requirement

The proposal eliminates the three-month requirement of creditable coverage in order for consumer protections to apply to State-based coverage. Under the proposal, in order for the consumer protections to apply in the case of an eligible TAA recipient or an eligible alternative TAA recipient, the individual must have a period of creditable coverage.

In the case of an eligible PBGC pension recipient, for the consumer protections to apply, the individual must enroll in the qualifying coverage during the 90-day period beginning on the later of (1) the last day of the first month that the individual becomes an eligible PBGC pension recipient or (2) the date of enactment. Under the proposal, the Secretary of the Treasury must carry out a program to notify individuals prior to their becoming eligible PBGC pension recipients of this new requirement.

Rules for determining lapse in creditable coverage

Under the proposal, in determining if there has been a 63-day lapse in coverage, in the case of a TAA-eligible individual, the period beginning on the date the individual has a TAA-related loss of coverage and ending on the date which is five days after the postmark date on the notice by the Secretary (or by any person designated by the Secretary) that the individual is eligible for a qualified health insurance costs credit eligibility certificate (under section 7527) is not taken into account.

Rating system requirement for certain State-based coverage

The proposal adds an additional requirement to State-based coverage. Under the proposal, in the case of coverage through an arrangement entered into by a State and an issuer of health insurance, premiums for such coverage must be restricted, based on a community rating system with respect to eligible individuals and their qualifying family members, or based on a rate-band system under which the maximum rate which may be charged does not exceed 150 percent of the standard rate with respect to eligible individuals and their qualifying family members.

GAO study

The proposal requires the Comptroller General of the U.S. to conduct a study regarding the HCTC to be submitted to Congress no later than March 31, 2009. The study is to include an analysis of (1) the administrative costs of the Federal government with respect to the credit and the advance payment of the credit and of providers of qualified health insurance with respect to providing such insurance to eligible individuals and their families, (2) the health status and relative risk status of eligible individuals and qualified family members covered under such insurance, (3) participation in the credit and the advance payment of the credit by eligible individuals and their qualifying family members, including the reasons why such individuals did or did not participate and the effects of the proposal on participation, and (4) the extent to which eligible individuals and their qualifying family members obtained health insurance other then qualifying insurance or went without insurance coverage. The proposal provides the Comptroller General access to the records within the possession or control of providers of qualified health insurance if determined relevant to the study. The Comptroller General may not disclose the identity of any provider of qualified health insurance or eligible individual in making information available to the public.

Sunset of tax credit program

Under the proposal, the credit is not available for any month beginning after December 31, 2009, except in the case of an individual who was an eligible individual for a continuous period of months ending with such month and beginning before such date.

Effective date

The proposal is effective for months beginning after the December 31, 2007.

The proposal relating to the rating system requirement for certain State-based coverage is effective for months beginning after March 31, 2008.

For purposes of carrying out the advance payment program, the proposal provides that the Secretary may provide that the certain provisions do not apply to one or more months beginning after March 31, 2008, to the extent that the Secretary determines that such delay is necessary to properly implement the proposal as part of the advance payment program. This rule applies to the provisions relating to modification of the training requirement, eligibility made retroactive to TAA-related loss of employment, and continued qualification of family members after certain events.

B. Manufacturing Redevelopment Zones

Designation and Eligibility Rules

Designation

The Secretary of the Treasury shall designate not more than 24 manufacturing redevelopment zones (the "zones") during the two-year period beginning on the date of enactment of this proposal. These zones shall be selected from among areas nominated for designation by their State or local governments. The aggregate population of the designated zones shall not exceed 2 million. This determination of population shall be made on the basis of the most recent decennial census for which data area available.

Any such designation shall remain in effect during the period beginning on the date of designation and ending the earliest of: (1) the close of the tenth calendar year beginning on or after the date of the designation; (2) the termination date designated by the State or local governments as provided for in their nomination; or (3) the date the Secretary revokes the designation. The Secretary may revoke a designation, if the Secretary determines that the local government or State in which it is located; (1) has modified the boundaries of the area; or (2) is not complying substantially with or fails to make progress in achieving the benchmarks set forth in the strategic plan included in the application.

Rules similar to the rules for designation and application of enterprise communities and empowerment zones shall apply to manufacturing redevelopment zones (sec. 1391(e) and (f) of the Internal Revenue Code (the "Code")).[11]

Eligibility criteria

A nominated area shall be eligible for designation as a manufacturing redevelopment zone on if three requirements are satisfied. The area: (1) must meet the eligibility criteria (e.g., population, distress, size and poverty rate[12] criteria) applicable to enterprise communities and empowerment zones (sec. 1392); (2) must have experienced a significant decline in the number of individuals employed in manufacturing or has a high concentration of abandoned or underutilized manufacturing facilities; and (3) no portion of the nominated area is located in an empowerment zone (sec. 1391) or renewal community (sec. 1400E) unless the local government which nominated the area elects to terminate such designation as an empowerment zone or renewal community.

The terms defined in sec. 1393 with regard to enterprise communities and empowerment zones shall have the same meaning with regard to manufacturing redevelopment zones. Finally,

[11] All references are to the Internal Revenue Code of 1986.

[12] The Secretary may waive the poverty rate criteria, where necessary to carry out the purposes of this proposal, if the nominated area is within an MSA that has experienced a loss of manufacturing jobs in excess of 25 percent over the previous 20 years.

the special rules provided in sec. 1393 with regard to enterprise communities and empowerment zones shall apply with regard to manufacturing redevelopment zones.

1. Manufacturing redevelopment zone tax credit bonds

Present law

Tax-exempt bonds

In general

Subject to certain Code restrictions, interest on bonds issued by State and local government generally is excluded from gross income for Federal income tax purposes. Bonds issued by State and local governments may be classified as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons. For this purpose, the term "nongovernmental person" generally includes the Federal Government and all other individuals and entities other than States or local governments. The exclusion from income for interest on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other Code requirements are met.

Private activity bond tests

Present law provides two tests for determining whether a State or local bond is in substance a private activity bond, the private business test and the private loan test.[13]

Private business tests

Private business use and private payments result in State and local bonds being private activity bonds if both parts of the two-part private business test are satisfied–

- More than 10 percent of the bond proceeds is to be used (directly or indirectly) by a private business (the "private business use test"); and
- More than 10 percent of the debt service on the bonds is secured by an interest in property to be used in a private business use or to be derived from payments in respect of such property (the "private payment test").[14]

[13] Sec. 141(b) and (c).

[14] The 10-percent private business use and payment threshold is reduced to five percent for private business uses that are unrelated to a governmental purpose also being financed with proceeds of the bond issue. In addition, as described more fully below, the 10-percent private business use and private payment thresholds are phased-down for larger bond issues for the financing of certain "output" facilities. The term output facility includes electric generation, transmission, and distribution facilities.

Private business use generally includes any use by a business entity (including the Federal government), which occurs pursuant to terms not generally available to the general public. For example, if bond-financed property is leased to a private business (other than pursuant to certain short-term leases for which safe harbors are provided under Treasury regulations), bond proceeds used to finance the property are treated as used in a private business use, and rental payments are treated as securing the payment of the bonds. Private business use also can arise when a governmental entity contracts for the operation of a governmental facility by a private business under a management contract that does not satisfy Treasury regulatory safe harbors regarding the types of payments made to the private operator and the length of the contract.[15]

Private loan test

The second standard for determining whether a State or local bond is a private activity bond is whether an amount exceeding the lesser of (1) five percent of the bond proceeds or (2) $5 million is used (directly or indirectly) to finance loans to private persons. Private loans include both business and other (e.g., personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test. Present law provides that the substance of a transaction governs in determining whether the transaction gives rise to a private loan. In general, any transaction which transfers tax ownership of property to a private person is treated as a loan.

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond (sec. 141(e)). The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities (sec. 142(a)).

In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater.

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[15] See Treas. Reg. sec. 1.141-3(b)(4) and Rev. Proc. 97-13, 1997-1 C.B. 632.

Arbitrage restrictions

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[16] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[17] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Tax Credit Bonds

In general

As an alternative to traditional tax-exempt bonds, the Code permits three types of tax-credit bonds. States and local governments have the authority to issue qualified zone academy bonds ("QZABS"), clean renewable energy bonds ("CREBS"), and "Gulf tax credit bonds."[18]

A common feature of the present law tax-credit bonds is that the taxpayer holding such a bond receives a tax credit, rather than an interest payment. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the taxpayer's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of such bonds without discount and interest cost to the qualified issuer. The credit is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

Clean renewable energy bonds

CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[19] The term "qualified issuers" includes (1) governmental bodies (including Indian tribal

[16] Sec. 103(a) and (b)(2).

[17] Sec. 148.

[18] Secs. 1397E, 54, and 1400N(l), respectively.

[19] In addition, Notice 2006-7 provides that qualified projects include any facility owned by a qualified borrower that is functionally related and subordinate to any facility described in section 45(d)(1) through (d)(9) and owned by such qualified borrower.

governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

In addition to the above requirements, at least 95 percent of the proceeds of CREBs must be spent on qualified projects within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any "nonqualified bonds." The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

CREBs also are subject to the arbitrage requirements of section 148 that apply to tax-exempt bonds. Principles under section 148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to CREBs.

Issuers of CREBs are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. There is a national CREB limitation of $1.2 billion. The maximum amount of CREBs that may be allocated to qualified projects of governmental bodies is $750 million. CREBs must be issued before January 1, 2009.

Qualified zone academy bonds

"QZABs" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy," and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. Eligible holders of QZABs are limited to financial institutions.

An issuer of QZABs must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified zone academy property within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified zone academy property during the five-year spending period, bonds will continue to qualify as QZABs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any nonqualified bonds. For these purposes, the amount of nonqualified bonds is to be determined in the same manner as Treasury regulations under section 142. The provision provides that the five-year spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable cause and the related purposes for issuing the bonds will continue to proceed with due diligence.

A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2007. The $400 million aggregate bond cap is allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Issuers of QZABs are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. In addition, QZABs are subject to the arbitrage requirements of section 148 that apply to tax-exempt bonds. Principles under section 148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to QZABs.

Gulf tax credit bonds

Gulf tax credit bonds were authorized for issuance by the States of Louisiana, Mississippi, and Alabama in calendar year 2006. To qualify as Gulf tax credit bonds, 95 percent or more of the proceeds of such bonds must be used to (i) pay principal, interest, or premium on a bond (other than a private activity bond) that was outstanding on August 28, 2005, and was issued by the State issuing the Gulf tax credit bonds, or any political subdivision thereof, or (ii) make a loan to any political subdivision of such State to pay principal, interest, or premium on a bond issued by such political subdivision.

The maximum amount of Gulf tax credit bonds authorized to be issued was $200 million in the case of Louisiana, $100 million in the case of Mississippi, and $50 million in the case of Alabama. As with CREBs and QZABs, issuers of Gulf tax credit bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

Description of Proposal

The proposal creates a new category of tax-credit bonds, “Manufacturing Redevelopment Tax Credit Bonds.” A Manufacturing Redevelopment Tax Credit Bond means any bond if: (1) 100 percent of the available project proceeds of the bond are to be used for qualified manufacturing redevelopment purposes within the three-year period that begins on the date of issuance; (2) the bond is not a private activity bond (as defined in section 141); and (3) the bond is designated as a manufacturing redevelopment bond by the local government which nominated the area to which such bond relates.

Under the proposal, the term “qualified manufacturing redevelopment purpose” means capital expenditures paid or incurred with respect to property located in a manufacturing redevelopment zone for purposes of promoting development or other economic activity. Examples of qualified manufacturing redevelopment purposes include, but are not limited to, expenditures for environmental remediation, improvements to public infrastructure, and construction of public facilities.

The proposal defines “available project proceeds” as proceeds from the sale of an issue of Manufacturing Redevelopment Tax Credit Bonds, less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified manufacturing redevelopment purposes during the three-year spending period, bonds will continue to qualify as Manufacturing

Redevelopment Tax Credit Bonds if outstanding bonds are redeemed within 90 days from the end of such three-year period. The three-year spending period may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Manufacturing Redevelopment Tax Credit Bonds generally are subject to the arbitrage requirements of section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner such that the fund will not exceed the amount necessary to repay the issue if invested at the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the Manufacturing Redevelopment Bonds are issued; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the Manufacturing Redevelopment Tax Credit Bonds are issued.

The maturity of Manufacturing Redevelopment Tax Credit Bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the Manufacturing Redevelopment Tax Credit Bonds are issued.

As with present-law tax credit bonds, the taxpayer holding Manufacturing Redevelopment Tax Credit Bonds on a credit allowance date is entitled to a tax credit. The credit rate on the bonds is determined by the Secretary to be a rate that permits issuance of the bonds without discount and interest cost to the qualified issuer. The amount of the tax credit to the holder is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit accrues quarterly, is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability. Unused credits in one year may be carried forward to succeeding taxable years.

Under the proposal, the maximum aggregate face amount of Manufacturing Redevelopment Tax Credit Bonds that can be issued in any manufacturing redevelopment zone is $150 million.

Effective Date

The proposal is effective for bonds issued after December 31, 2007.

2. Manufacturing redevelopment zone private activity bonds

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds").

Qualified private activity bonds

Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond (sec. 141(e)).

The definition of an exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities (sec. 142(a)).

In most cases, the aggregate volume of qualified private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State ("State volume cap"). For calendar year 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater. Exceptions to the State volume cap are provided for bonds for certain governmentally owned facilities (e.g., airports, ports, high-speed intercity rail, and solid waste disposal) and bonds which are subject to separate local, State, or national volume limits (e.g., public/private educational facility bonds, enterprise zone facility bonds, qualified green building bonds, and qualified highway or surface freight transfer facility bonds).

Qualified private activity bonds generally are subject to restrictions on the use of proceeds for the acquisition of land and existing property. In addition, qualified private activity bonds generally are subject to restrictions on the use of proceeds to finance certain specified facilities (e.g., airplanes, skyboxes, other luxury boxes, health club facilities, gambling facilities, and liquor stores), and use of proceeds to pay costs of issuance (e.g., bond counsel and underwriter fees). Small issue and redevelopment bonds also are subject to additional restrictions on the use of proceeds for certain facilities (e.g., golf courses and massage parlors).

Moreover, the term of qualified private activity bonds generally may not exceed 120 percent of the economic life of the property being financed and certain public approval requirements (similar to requirements that typically apply under State law to issuance of governmental debt) apply under Federal law to issuance of private activity bonds.

New York Liberty Zone Bonds

Present law permits an aggregate of $8 billion in exempt facility bonds for the purpose of financing the construction and rehabilitation of nonresidential real property and residential rental real property in a designated "Liberty Zone" (the "Zone") of New York City ("Liberty Zone bonds"). The Zone consists of all business addresses located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan.

Property eligible for financing with these bonds includes buildings and their structural components, fixed tenant improvements, and public utility property (e.g., gas, water, electric, and telecommunication lines). Fixtures and equipment that could be removed from the designated zone for use elsewhere are not eligible for financing with these bonds. Issuance of these bonds is limited to projects approved by the Mayor of New York City or the Governor of New York State, each of whom may designate up to $4 billion of the aggregate bond authority.

Liberty Zone Bonds must be issued before January 1, 2010, and are not subject to the State volume cap.

Gulf Opportunity Zone Bonds

Present law permits the issuance of qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone ("Gulf Opportunity Zone Bonds").[20] Gulf Opportunity Zone Bonds must be issued before January 1, 2011.

Gulf Opportunity Zone Bonds may be issued by the State of Alabama, Louisiana, or Mississippi, or any political subdivision thereof. Gulf Opportunity Zone Bonds are not subject to the State volume cap. Rather, the maximum aggregate face amount of Gulf Opportunity Zone Bonds that may be issued in any State is limited to $2,500 multiplied by the population of the respective State within the Gulf Opportunity Zone. Depending on the purpose for which such bonds are issued, Gulf Opportunity Zone Bonds are treated as either exempt facility bonds or qualified mortgage bonds.

Gulf Opportunity Zone Bonds are treated as exempt facility bonds if 95 percent or more of the net proceeds of such bonds are to be used for qualified project costs located in the Gulf

[20] The "Gulf Opportunity Zone" is defined as that portion of the Hurricane Katrina Disaster Area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of Hurricane Katrina.

Opportunity Zone. Qualified project costs include the cost of acquisition, construction, reconstruction, and renovation of nonresidential real property, qualified residential rental projects (as defined in section 142(d) with certain modifications), and public utility property.

Empowerment Zones

The Omnibus Budget Reconciliation Act of 1993 authorized the designation of nine empowerment zones to provide tax incentives for businesses to locate within targeted areas (section 1391(b)(2)). The Taxpayer Relief Act of 1997 authorized the designation of 22 additional empowerment zones (1391(g)(1)). The Community Renewal Tax Relief Act of 2000 authorized the designation of nine additional empowerment zones (bringing the total to 40 empowerment zones) (1391(h)). To be designated as an empowerment zone, the nominated area must satisfy certain size, population, and poverty criteria (that vary depending on whether the area is urban or rural).

The 40 empowerment zones permit businesses located in the empowerment zones to qualify for a number of tax incentives, including expanded tax-exempt private activity bond authority to finance certain depreciable property in an empowerment zone. The tax incentives with respect to the empowerment zones generally are available through December 31, 2009.

Description of Proposal

The proposal creates a new category of qualified private activity bonds, "Manufacturing Redevelopment Zone Bonds." A Manufacturing Redevelopment Zone Bond means any bond issued as part of an issue if: (1) 95 percent or more of the net proceeds of such issue are to be used for manufacturing zone property and (2) the bond is designated as a Manufacturing Redevelopment Zone Bond by the local government which nominated the area to which such bond relates.

Under the proposal, the term "manufacturing zone property" means any property subject to depreciation (to which section 168 applies) if (1) such property was acquired by the taxpayer by purchase after the date on which the designation of the manufacturing redevelopment zone took effect; (2) the original use of such property in the manufacturing redevelopment zone commences with the taxpayer; and (3) substantially all of the use of such property is in the manufacturing redevelopment zone and is in the active conduct of a qualified business by the taxpayer in such zone. The term "qualified business" means any trade or business except that the rental to others of real property located in a manufacturing redevelopment zone shall be treated as a qualified business only if the property is not residential rental property (as defined in section 168(e)(2)).

Subject to the following exceptions and modifications, issuance of Manufacturing Redevelopment Zone Bonds is subject to the general rules applicable to issuance of qualified private activity bonds:

(1) Issuance of the bonds is not subject to the aggregate annual State private activity bond volume limits (sec. 146);

(2) The restriction on acquisition of existing property does not apply (sec. 147(d)), unless such acquisition is inconsistent with the definition of manufacturing zone property;

(3) Interest on the bonds is not a preference item for purposes of the alternative minimum tax preference for private activity bond interest (sec. 57(a)(5)); and

(4) No portion of the proceeds of the bonds may be used to provide any property described in section 144(c)(6)(B) (i.e., any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal purpose of which is the sale alcoholic beverages for consumption off premises).

Under the proposal, the maximum aggregate face amount of Manufacturing Redevelopment Zone Bonds that can be issued in any manufacturing redevelopment zone is $230 million. In addition, the amount of Manufacturing Redevelopment Zone Bonds that can be allocated to any person cannot exceed (1) $15 million in any one manufacturing redevelopment zone or (2) $20 million in all manufacturing redevelopment zones.

Effective Date

The proposal is effective for bonds issued after December 31, 2007.

3. Increase the low-income housing credit cap for manufacturing redevelopment zones

Present Law

In general

The low-income housing credit may be claimed over a 10-year period for the cost of rental housing occupied by tenants having incomes below specified levels. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

The credit percentage for newly constructed or substantially rehabilitated housing that is not Federally subsidized is adjusted monthly by the Internal Revenue Service so that the 10 annual installments have a present value of 70 percent of the total qualified basis. The credit percentage for newly constructed or substantially rehabilitated housing that is Federally subsidized and for existing housing that is substantially rehabilitated is calculated to have a present value of 30 percent of qualified basis. These are referred to as the 70-percent credit and 30-percent credit, respectively.

Credit cap

Generally, the aggregate credit authority provided annually to each State for calendar year 2007 is $1.95 per resident with a minimum annual cap of $2,275,000 for certain small population States. These amounts are indexed for inflation. These limits do not apply in the case of projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit.

Stacking rule

Authority to allocate credits remains at the State (as opposed to local) government level unless State law provides otherwise. Generally, credits may be allocated only from volume authority arising during the calendar year in which the building is placed in service, except in the case of: (1) credits claimed on additions to qualified basis; (2) credits allocated in a later year pursuant to an earlier binding commitment made no later than the year in which the building is placed in service; and (3) carryover allocations.

Each State annually receives low-income housing credit authority equal to $1.90 per State resident for allocation to qualified low-income projects. In addition to this $1.90 per resident amount, each State's "housing credit ceiling" includes the following amounts: (1) the unused State housing credit ceiling (if any) of such State for the preceding calendar year; (2) the amount of the State housing credit ceiling (if any) returned in the calendar year; and (3) the amount of the national pool (if any) allocated to such State by the Treasury Department.

The national pool consists of States' unused housing credit carryovers. For each State, the unused housing credit carryover for a calendar year consists of the excess (if any) of the unused State housing credit ceiling for such year over the excess (if any) of the aggregate housing credit dollar amount allocated for such year over the sum of $1.90 per resident and the credit returns for such year. The amounts in the national pool are allocated only to States that allocated their entire housing credit ceiling for the preceding calendar year and requested a share in the national pool not later than May 1 of the calendar year. The national pool allocation to qualified States is made on a pro rata basis equivalent to the fraction that a State's population enjoys relative to the total population of all qualified States for that year.

The present-law stacking rule provides that each State is treated as using its allocation of the unused State housing credit ceiling (if any) from the preceding calendar before the current year's allocation of credit (including any credits returned to the State) and then finally any national pool allocations.

Description of Proposal

Credit cap

Under the proposal, the Secretary of the Treasury may designate a specified number of manufacturing redevelopment zones subject to an overall population cap.

While a designation of a manufacturing redevelopment zone is in effect (up to 10 years beginning with the calendar year in which the designation goes into effect) a State's otherwise applicable housing credit ceiling is increased by the manufacturing zone housing amount for each manufacturing redevelopment zone located within such State. The manufacturing zone housing amount equals $20 times the number of such State's residents within the manufacturing redevelopment zone. For purposes of the manufacturing zone housing amount, the determination of population for any calendar year is made on the basis of the most recent census estimate.

The amount of the State's increase in the otherwise applicable housing credit ceiling is the lesser of: (a) the actual housing credit dollar amount allocated from the State housing credit agency to buildings located in the manufacturing redevelopment zone for a calendar year; or (b) the aggregate manufacturing zone housing amount for that manufacturing redevelopment zone minus all the increases under this proposal in the State's ceiling in previous calendar years of that manufacturing redevelopment zone's designation.

Any subsequent returns (from the developer to the State housing credit agency) of a credit allocation from the manufacturing zone housing amount are eligible to be reallocated under this special rule but are not treated as returns under the otherwise applicable housing credit ceiling.

Effective Date

The proposals are generally effective for calendar years beginning after 2007.

4. Expansion of the Work Opportunity Tax Credit

Present Law

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

(1) Families receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (e.g., a State employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified veteran

A qualified veteran is a veteran who is certified by the designated local agency: (1) as a member of a family certified as receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least three months part of which is during the 12-month period ending on the hiring date;[21] or (2) as entitled to compensation for a service-connected disability and: (a) having a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States, or (b) having been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring.[22]

For these purposes, a veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not a qualified veteran if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(3) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law, and (2) having a hiring date within one year of release from prison or date of conviction.

(4) Designated community residents

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community (as defined under Subchapter U of Subtitle A, Chapter 1 of the Code) or rural renewal county (defined as a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990-1994 and 1995-1999). Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community, or rural renewal community.

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[21] For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a food stamp program under the Food Stamp Act of 1977.

[22] Being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S.C., which means having a disability rating of 10-percent or higher for service connected injuries.

(5) Vocational rehabilitation referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a State plan approved under the Rehabilitation Act of 1973; (b) a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code; or (c) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act with respect to which the requirements of such subsection are met. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified summer youth employee

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15, (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date, (3) who has not been an employee of that employer before, and (4) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community (as defined under Subchapter U of Subtitle A, Chapter 1 of the Code. As with high-risk youths, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first year wages will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified food stamp recipient

A qualified food stamp recipient is an individual aged 18 but not yet 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food stamps under section 6(o) of the Food Stamp Act of 1977, the six-month requirement is replaced with a requirement that the family has been receiving food stamps for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food stamp program under the Food Stamp Act of 1977.

(8) Qualified SSI recipient

A qualified SSI recipient is an individual certified by a designated local agency as receiving supplemental security income (“SSI”) benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-term family assistance recipients

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit)[23] if the individual is hired within two years after the date that the 18-month total is reached; or (3) a member of a family who is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within two years after the Federal or State time limits made the family ineligible for family assistance.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). There are two exceptions to this general rule. First, with respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Second, with respect to qualified veterans who are entitled to compensation for a service-connected disability, the maximum credit is $4,800 because qualified first-year wages are $12,000 rather than $6,000 for such individuals.[24] Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year

[23] The welfare-to-work tax credit was consolidated into the work opportunity tax credit in the Tax Relief and Health Care Act of 2006 for qualified individuals who begin to work for an employer after December 31, 2006.

[24] The expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food stamp program, as defined under present law.

wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

Certification rules

An individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after August 31, 2011.

Description of Proposal

The proposal would add residents of manufacturing redevelopment zones to the category of designated community residents for purposes of the work opportunity tax credit.

Effective Date

The proposal is effective for wages paid or incurred for individuals who begin work for an employer after the date of enactment.

C. Delay Implementation of Worldwide Interest Allocation

Present Law

In general

In order to compute the foreign tax credit limitation, a taxpayer must determine the amount of its taxable income from foreign sources. Thus, the taxpayer must allocate and apportion deductions between items of U.S.-source gross income, on the one hand, and items of foreign-source gross income, on the other.

In the case of interest expense, the rules generally are based on the approach that money is fungible and that interest expense is properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring an obligation on which interest is paid.[25] For interest allocation purposes, all members of an affiliated group of corporations generally are treated as a single corporation (the so-called "one-taxpayer rule") and allocation must be made on the basis of assets rather than gross income. The term "affiliated group" in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns.

For consolidation purposes, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if: (1) the common parent owns directly stock possessing at least 80 percent of the total voting power and at least 80 percent of the total value of at least one other includible corporation; and (2) stock meeting the same voting power and value standards with respect to each includible corporation (excluding the common parent) is directly owned by one or more other includible corporations.

Generally, the term "includible corporation" means any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation.

Subject to exceptions, the consolidated return and interest allocation definitions of affiliation generally are consistent with each other.[26] For example, both definitions generally exclude all foreign corporations from the affiliated group. Thus, while debt generally is considered fungible among the assets of a group of domestic affiliated corporations, the same

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[25] However, exceptions to the fungibility principle are provided in particular cases, some of which are described below.

[26] One such exception is that the affiliated group for interest allocation purposes includes section 936 corporations that are excluded from the consolidated group.

rules do not apply as between the domestic and foreign members of a group with the same degree of common control as the domestic affiliated group.

Banks, savings institutions, and other financial affiliates

The affiliated group for interest allocation purposes generally excludes what are referred to in the Treasury regulations as "financial corporations" (Treas. Reg. sec. 1.861-11T(d)(4)). These include any corporation, otherwise a member of the affiliated group for consolidation purposes, that is a financial institution (described in section 581 or section 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by State or Federal law to be operated separately from any other entity which is not a financial institution (sec. 864(e)(5)(C)). The category of financial corporations also includes, to the extent provided in regulations, bank holding companies (including financial holding companies), subsidiaries of banks and bank holding companies (including financial holding companies), and savings institutions predominantly engaged in the active conduct of a banking, financing, or similar business (sec. 864(e)(5)(D)).

A financial corporation is not treated as a member of the regular affiliated group for purposes of applying the one-taxpayer rule to other non-financial members of that group. Instead, all such financial corporations that would be so affiliated are treated as a separate single corporation for interest allocation purposes.

Worldwide interest allocation

In general

The American Jobs Creation Act of 2004 ("AJCA")[27] modifies the interest expense allocation rules described above (which generally apply for purposes of computing the foreign tax credit limitation) by providing a one-time election (the "worldwide affiliated group election") under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally is determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis (i.e., as if all members of the worldwide group were a single corporation). If a group makes this election, the taxable income of the domestic members of a worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the third-party interest expense of those domestic members to foreign-source income in an amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide third-party interest expense multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated group,[28] over (2) the third-party interest expense incurred by foreign members of the group to the extent such interest would be allocated to foreign sources if the

[27] Pub. L. No. 108-357, sec. 401 (2004).

[28] For purposes of determining the assets of the worldwide affiliated group, neither stock in corporations within the group nor indebtedness (including receivables) between members of the group is taken into account.

principles of worldwide interest allocation were applied separately to the foreign members of the group.[29]

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group as well as all controlled foreign corporations that, in the aggregate, either directly or indirectly,[30] would be members of such an affiliated group if section 1504(b)(3) did not apply (i.e., in which at least 80 percent of the vote and value of the stock of such corporations is owned by one or more other corporations included in the affiliated group). Thus, if an affiliated group makes this election, the taxable income from sources outside the United States of domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group, as modified to include insurance companies) and certain controlled foreign corporations were attributable to a single corporation.

The common parent of the domestic affiliated group must make the worldwide affiliated group election. It must be made for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election applies to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election was made and all subsequent taxable years, unless revoked with the consent of the Secretary of the Treasury.

Financial institution group election

Taxpayers are allowed to apply the bank group rules to exclude certain financial institutions from the affiliated group for interest allocation purposes under the worldwide fungibility approach. The rules also provides a one-time "financial institution group" election that expands the bank group. At the election of the common parent of the pre-election worldwide affiliated group, the interest expense allocation rules are applied separately to a subgroup of the worldwide affiliated group that consists of (1) all corporations that are part of the bank group, and (2) all "financial corporations." For this purpose, a corporation is a financial corporation if at least 80 percent of its gross income is financial services income (as described in section 904(d)(2)(C)(i) and the regulations thereunder) that is derived from transactions with unrelated persons.[31] For these purposes, items of income or gain from a transaction or series of

[29] Although the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return.

[30] Indirect ownership is determined under the rules of section 958(a)(2) or through applying rules similar to those of section 958(a)(2) to stock owned directly or indirectly by domestic partnerships, trusts, or estates.

[31] See Treas. Reg. sec. 1.904-4(e)(2).

transactions are disregarded if a principal purpose for the transaction or transactions is to qualify any corporation as a financial corporation.

The common parent of the pre-election worldwide affiliated group must make the election for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group includes a financial corporation. Once made, the election applies to the financial institution group for the taxable year and all subsequent taxable years. In addition, anti-abuse rules are provided under which certain transfers from one member of a financial institution group to a member of the worldwide affiliated group outside of the financial institution group are treated as reducing the amount of indebtedness of the separate financial institution group. Regulatory authority is provided with respect to the election to provide for the direct allocation of interest expense in circumstances in which such allocation is appropriate to carry out the purposes of these rules, to prevent assets or interest expense from being taken into account more than once, or to address changes in members of any group (through acquisitions or otherwise) treated as affiliated under these rules.

Effective date of worldwide interest allocation under AJCA

The worldwide interest allocation rules under AJCA are effective for taxable years beginning after December 31, 2008.

Description of Proposal

The proposal delays the effective date of worldwide interest allocation rules for three years, until taxable years beginning after December 31, 2011. The required dates for making the worldwide affiliated group election and the financial institution group election are changed accordingly.

Effective Date

The proposal is effective on the date of enactment.