DESCRIPTION OF THE PRESIDENT'S TAX PROPOSALS INCLUDED IN THE FISCAL YEAR 1993 BUDGET AND AS INTRODUCED IN H.R. 4210

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the President's tax proposals included in the Fiscal Year 1993 Budget,[2] and as included in H.R. 4210 (introduced by Mr. Gephardt by request on February 11, 1992).[3]

Part I of the document is a description of the tax proposals which are divided into three titles:

Title I-- Economic Growth Acceleration Act of 1992;
Title II-- Tax Relief for Families Act of 1992; and
Title III--Long Term Growth Act of 1992.

Part II presents a table showing the Joint Committee on Taxation staff estimates of the budget effect of the President's tax proposals for fiscal years 1992-1997.

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[1] This document may be cited as follows: Description of the President's Tax Proposals Included in the Fiscal Year 1993 Budget and As Introduced in H.R. 4210 (JCX-4-92), February 11, 1992.

[2] Budget of the United States Government for Fiscal Year 1993, Part Two. See also Department of the Treasury, General Explanations of the President's Budget Proposals Affecting Receipts, January 1992.

[3] The provisions of H.R. 4210 are the tax provisions of H.R. 4150 as introduced by Mr. Michel on February 4, 1992, that are exclusively within the jurisdiction of the Committee on Ways and Means.

I. EXPLANATION OF PROVISIONS

TITLE I--ECONOMIC GROWTH ACCELERATION ACT OF 1992

Subtitle A--Provisions Relating to Capital Gains (secs. 111 and 112 of the bill; secs. 1222, 170, 56, 62, 163, 172, 221, 642, 643, 691, 871, 1402, 1250, 453, 48, 267, 291, 265, 1277, 1017, and 7701 of the Code; and new sec. 1202 of the Code)

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.

Explanation of Provision

The provisions would allow noncorporate taxpayers 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.

Effective Date

The provision would apply to dispositions (and installment payments received) on or after February 1, 1992. 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.

Subtitle B--Provisions Relating to Passive Losses and Depreciation

1. Passive Loss Relief for Real Estate Developers (sec. 121 of the bill and sec. 469 of the Code)

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.

Explanation of Provision

Under the proposal, a taxpayer who materially participates in a real estate development activity during the taxable year may treat the rental of certain real property ("Qualified Property") as a non-rental activity that is part

of such taxpayer's real estate development activity. The consequences of this treatment are: (1) income and loss for the taxable year from Qualified Property will not be treated as passive and (2) losses arising from Qualified Property in a prior year that were suspended and carried forward under the passive loss rules will be treated as losses from a former passive activity and, as such, will be allowed to the extent of the taxpayer's income from his real estate development activity in the current year.

In order to be Qualified Property, rental real property must meet the following criteria: (1) the rental real property was constructed or substantially renovated in a real estate development activity of the taxpayer at a time when the taxpayer materially participated in the activity; (2) the taxpayer has had an ownership interest (other than as a limited partner) in the rental real property continuously since it was developed; and (3) the taxpayer actively participates in such rental real property during the current taxable year.

For purposes of this rule, a taxpayer's real estate development activity will be considered a single trade or business activity which will consist of all activities in which the taxpayer actively participates and which consist of (1) construction, substantial renovation, or management services provided with respect to real property, (2) sales or lease-up services provided with respect to real property in which the taxpayer has at least a 10% ownership interest, and (3) the rental of Qualified Property. Material participation and active participation are generally to have the same meaning as under present law; however, active participation does not require a 10 percent ownership interest.

Effective Date

The proposal is effective with respect to taxable years ending on or after December 31, 1992.

2. Special Allowance for Equipment Acquired in 1992 (sec. 122 of the bill and secs. 56 and 168 of the Code)

Present Law

Depreciation deductions

A taxpayer is allowed to 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).

Explanation of Provision

The bill allows an additional first-year depreciation deduction equal to 15 percent of the adjusted basis of certain qualified property that is placed in service before July 1, 1993. The additional depreciation deduction is 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 are appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer may elect to not claim the additional first-year depreciation for qualified property.

Property qualifies for the additional first-year depreciation deduction if (1) the property is section 1245 property to which ACRS applies (other than property that is required to be depreciated under the alternative depreciation system of ACRS) and (2) the original use of the property commences with the taxpayer.[1] In addition, the property must be acquired by the taxpayer (1) on or after February 1, 1992, but only if no binding contract for the acquisition is in effect before such date, or (2) pursuant to a binding contract which was entered into on or after February 1, 1992, and before January 1, 1993. Finally, property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer will qualify if the taxpayer begins manufacturing, construction, or production of the property on or after February 1, 1992, and before January 1, 1993 (and all other requirements are met).

The limitations on the amount of depreciation deductions allowed with respect to certain passenger automobiles and certain other listed property used for personal purposes (sec. 280F of the Code) are adjusted to reflect the additional first year depreciation deduction.

The following examples illustrate the operation of the provision.

Example 1.--Assume that on July 1, 1992, a calendar year taxpayer acquires and places in service qualified property that costs $1 million. Under the provision, the taxpayer is allowed an additional first-year depreciation deduction of $150,000. The remaining $850,000 of adjusted basis is to be recovered in 1992 and subsequent years pursuant to the depreciation rules of present law.

Example 2.--Assume that on July 1, 1992, a calendar year taxpayer acquires and places in service qualified property that costs $30,000. In addition, assume that the property qualifies for the expensing election under section 179 of present law. Under the provision, the taxpayer is first allowed a $10,000 deduction under section 179. The taxpayer then is allowed an additional first-year depreciation deduction of $3,000 based on $20,000 ($30,000 original cost less the section 179 deduction of $10,000) of adjusted basis.

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[1] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold and leased back by such person (or is leased to such person) within three months after the date that the property was placed in service, the property is to be treated as originally placed in service not earlier than the date that the property is used under the leaseback (or lease).

Finally, the remaining adjusted basis of $17,000 ($20,000 adjusted basis less $3,000 additional first-year depreciation) is to be recovered in 1992 and subsequent years pursuant to the depreciation rules of present law.

Effective Date

The provision applies to property acquired on or after February 1, 1992.

3. Elimination of ACE Depreciation Adjustment (sec. 123 of the bill and sec. 56 of the Code)

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.

Explanation of Provision

Effective for property placed in service on or after February 1, 1992, the provision 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).

Effective Date

The provision is effective for property placed in service on or after February 1, 1992.

Subtitle C--Provisions Relating to Real Estate Investments by Pension Funds (secs. 131 and 132 of the bill and secs. 512 and 514 of the Code)

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") (sec. 511). Certain types of income, including rents, royalties, dividends, and interest, are excluded from the UBIT, except where such income is derived from "debt-financed property." Income from debt-financed property, the use of which is unrelated to the organization's exempt purpose, generally is subject to the UBIT in proportion to 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 investments in debt-financed property only if the following restrictions of section 514(c)(9)(B) are satisfied: (1) the price of the real property is a fixed amount determined as of the date of the acquisition (the "fixed price" restriction); (2) the amount of the indebtedness or any amount payable with respect to 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 (the "participating loan" restriction); (3) the property is not leased by the qualified organization to the seller or to a person related to the seller (the "leaseback" restriction); (4) in the case of a pension trust, the seller or lessee of the property is not a disqualified person (the "disqualified person" restriction); (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 (the "seller-financing" restriction) and (6) if the investment in the property is held through a partnership, certain additional requirements must be satisfied by the partnership (the "partnership" restrictions) (sec. 514(c)(9)(B)(i) through (vi)).

Under a separate UBIT provision, 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)).

Explanation of Provision

Modify leaseback and disqualified person restrictions

The leaseback and disqualified person restrictions would be modified to permit a de minimis leaseback of debt-financed real property to the seller (or a party related to the seller) or to a disqualified person. 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) or to the disqualified person and (2) the lease is on commercially reasonable terms.

Modify seller-financing restriction.

The seller-financing restriction 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. The present-law "participating loan" restriction generally would remain in effect, so that a financing arrangement (such as an equity kicker) based on revenue, income, or profits would not be considered a commercially reasonable term.

Relax the participating loan restriction 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 conservatorship or receivership) that acquired the property by foreclosure; (2) the financial institution treats any income from the sale of the property as ordinary income and the stated principal amount of the seller financing does not exceed the stated principal 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 of the financing are commercially reasonable and are comparable to those of sales of foreclosure property not involving tax-exempt entities; and (4) the total amount payable

pursuant to any equity participation feature (including an equity kicker) does not exceed 25 percent of the stated principal amount of the seller-provided loan and must be paid no later than the earlier of the repayment of the stated principal amount or disposition of the property. Standards would be provided for determining a commercially reasonable interest rate for this purpose.

Relax 514(c)(9)(B) restrictions for investments through partnerships

The restrictions in section 514(c)(9)(B) generally would not apply to an investment made by a qualified trust or educational institution in (i) certain "large" partnerships and (ii) certain other partnerships.

A "large" partnership is a partnership having at least 250 partners that satisfies the following four tests: (1) investment units in the partnership are marketed primarily to individuals expected to be taxable at the highest marginal rate; (2) a significant percentage (at least 50 percent) of each class of interests is owned by such taxable individuals; (3) the partners that are qualified trusts or educational institutions participate on substantially the same terms as 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 restrictions contained in 514(c)(9)(B) would not apply to an investment made by a qualified trust or educational institution if the partnership satisfies the allocation rules (in section 514(c)(9)(E)) presently applicable to debt-financed investments in real estate through partnerships.

Repeal special UBIT rule for publicly-traded partnerships

The rule that automatically subjects investments in publicly traded partnerships to UBIT would be repealed. Thus, investments in publicly-trade partnerships would be treated the same as investments in other partnerships for purposes of the UBIT rules (in general, the UBIT character of income of the partnership is flowed through to the partners) (sec. 512(c)).

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.

Subtitle D--Provisions Affecting Homebuyers

1. Credit for First-Time Homebuyers (sec. 141 of the bill and new sec. 23 of the Code)

Present Law

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

Explanation of Provision

Under the provision, individuals who purchase a first home generally will receive an income tax credit equal to 10 percent of the purchase price of the home, up to a maximum credit of $5,000. The provision applies to a principal residence if the taxpayer acquires the residence on or after February 1, 1992, and before January 1, 1993, or the taxpayer enters into, on or after February 1, 1992, and before January 1, 1993, a binding contract to acquire the residence, and acquires and occupies the residence before July 1, 1993. 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 is 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 is not considered a first-time homebuyer until after the end of the extended rollover period.

The first-time homebuyer credit is 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 can 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.

Effective Date

The provision is effective on February 1, 1992.

2. Penalty-Free Withdrawals for First Home Purchase and for Certain Educational and Medical Expenses (secs. 142 and 213 of the bill and sec. 72 of the Code)

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.

Explanation of Provisions

The bill permits 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 on early withdrawals. This provision applies to individuals who did not own a home in the last 3 years and who are not in an extended period for rolling over gain from the sale of a principal residence.

The bill also provides an exception to the 10-percent additional tax 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 amount of qualified higher educational expenses for any taxable year is reduced by any amount excludable from gross income under the provision in the Code pertaining to U.S. education savings bonds.

In addition, the bill extends 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. Moreover, for purposes of the medical expense exception (with regard to both IRAs and

qualified retirement plans), a child, grandchild, or lineal ascendant of the taxpayer is treated as a dependent of the taxpayer in determining whether medical expenses are deductible.

Effective Date

The provisions are effective for withdrawals on or after February 1, 1992.

TITLE II--TAX RELIEF FOR FAMILIES ACT OF 1992

Subtitle A--Provisions Relating to Education and Savings

1. Deduction for Interest on Certain Educational Loans (sec. 211 of the bill; sec. 163 of the Code; and new sec. 60500 of the Code)

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.

Explanation of Provision

The provision 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 provision 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.

Effective Date

The deduction would be allowed for interest paid on or after July 1, 1992, and would be available for interest on existing loans as well as loans incurred after enactment.

2. Flexible Individual Retirement Accounts (sec. 212 of the bill; secs. 4975, 6693 and 408 of the Code; and new sec. 292 of the Code)

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.

Explanation of Provision

Under the provision, certain individuals can 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) are excluded from gross income.

The maximum annual amount that can be contributed by an individual under the provision generally is limited to the lesser of $2,500 or 100 percent of the individual's compensation for the year. Married taxpayers filing a joint return are 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 can make a contribution to a FIRA of up to $5,000. Dependents cannot make contributions to the account.

Only individuals meeting certain AGI limitations can make a contribution to a FIRA. Contributions are 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 do not affect the amount that can 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 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 are includible in gross income and are 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 are includible in gross income, but the additional 10-percent tax does not apply.

In addition to the annual limits for new contributions, individuals otherwise eligible to contribute to a FIRA can 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 are includible in income ratably over a 4-year period. The 10-percent tax on early withdrawals does not apply.

Effective Date

The provision is effective for taxable years beginning after December 31, 1991.

Subtitle B -- Other Provisions

1. Casualty Loss on Sale of Home; Basis Adjustment (sec. 221 of the bill and secs. 165 and 1016 of the Code)

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.

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.

Explanation of Provision

The provision 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.

Effective Date

The provision 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.

2. Family Tax Allowance (sec. 222 of the bill and sec. 151 of the Code)

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 years beginning in 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 percentage points. 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 heads 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.

Explanation of Provision

The provision would increase the personal exemption for dependent children who are under age 19 at the end of the taxable year by $500 per child. This amount would be indexed for inflation. The provision would be effective beginning October 1, 1992. For taxable years beginning in 1992, the amount of the personal exemption increase would be prorated.

Effective Date

The provision would be effective beginning October 1, 1992.

3. Extend Health Insurance Deduction for Self-Employed (sec. 223 of the bill and sec. 162 of the Code)

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.

Explanation of Provision

The provision extends the 25-percent deduction through December 31, 1993.

Effective Date

The provision would be effective on the date of enactment.

4. Adoption Expenses (sec. 224 of the bill; sec. 62 of the Code; and new sec. 220 of the Code)

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.

Explanation of Provision

The provision 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. The deduction for qualified adoption expenses would be allowed above-the-line in calculating adjusted gross income, and thus would be directly available to non-itemizers. 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 provision also clarifies that all reimbursements are includible in income to the recipient unless deductible under this provision.

Effective Date

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

5. Public Transit Fringe Benefit Exclusion (sec. 225 of the bill and sec. 132 of the Code)

Present Law

Under Treasury regulations, 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.

Explanation of Provision

The provision allows taxpayers to exclude up to $60 per month of employer-provided mass transit passes, tokens, etc. as a working condition fringe benefit. The $60 exclusion applies regardless of whether the total value exceeds $60 per month.

Effective Date

The provision is effective with respect to discounts and reimbursements for transit expenses provided on or after February 1, 1992.

TITLE III -- LONG TERM GROWTH ACT OF 1992

Subtitle A--Extension of Expiring Provisions

1. Credit for Research and Experimentation (sec. 311 of the bill and secs. 41 and 28 of the Code)

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 excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research over (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.

Explanation of Provision

The provision would extend permanently the 20-percent research tax credit for qualified research expenditures and university basic research expenditures.

2. Allocation of Research and Experimental Expenditures (sec. 312 of the bill and sec. 864 of the Code)

Present Law

Computation of the foreign tax credit requires the taxpayer to distinguish between taxable income from U.S. sources and taxable income from foreign sources, and thus to allocate and apportion deductions among items of U.S.-source and foreign-source gross income. Treasury regulations prescribe detailed methods for allocating and apportioning research and experimental (R&E) expenses.

The R&E allocation regulation was suspended in part by a succession of statutes, effective for taxable years beginning after August 13, 1981, and on or before August 1, 1987, for each taxpayer's first taxable year beginning after August 1, 1987, and for each taxpayer's first three taxable years beginning after August 1, 1989, and on or before August 1, 1992. In taxable years beginning after August 13, 1981 and on or before August 1, 1986, all U.S.-incurred R&E expenses were allocated to U.S.-source income. In taxable years beginning after August 1, 1986 and on or before August 1, 1987, 50 percent of such expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographic 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 a taxpayer's first taxable year beginning after August 1, 1987 were given bifurcated treatment. Generally, for one third of the year's R&E expenses (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 was allocated to U.S.-source income, 64 percent of foreign-incurred R&E expenses was allocated to foreign-source income, and the remainder of R&E expenses was 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 be no less than 30 percent of the amount that would have been

apportioned to foreign-source income had the sales method been used.

Generally, for the remainder of a taxpayer's first taxable year beginning after August 1, 1987 (and for subsequent taxable years), the rules set forth in regulation section 1.861-8 were applicable with respect to the allocation and apportionment of research and experimental expenditures.

The statutory rules for allocating research expenditures that applied to one-third of the research expenses incurred in a taxpayer's first taxable year beginning after August 1, 1987, were extended, again on a temporary basis, in 1989, and were codified in section 864(f) of the Internal Revenue Code. As codified in 1989, these rules were effective only for the first nine months of a taxpayer's first taxable year beginning after August 1, 1989, and before August 2, 1990 (treating all applicable expenditures in that taxable year as if they were incurred ratably over the year). For the remainder of a taxpayer's first taxable year beginning after August 1, 1989, and before August 2, 1990 (and for subsequent taxable years), the rules set forth in regulation section 1.861-8 would have applied with respect to the allocation and apportionment of research and experimental expenditures.

The statutory allocation rules that were codified in 1989 were further extended in 1990 and 1991, so that the rules of section 864(f) generally apply to the taxpayer's first three taxable years beginning after August 1, 1989, and on or before August 1, 1992. In the case of the taxpayer's first taxable year beginning after August 1, 1991, however, the rules of section 864(f) apply only to research expenses paid or incurred during the first six months of that year.

Explanation of Proposal

The bill temporarily extends, generally for 18 months, the period for the application of Code section 864(f), which provides statutory allocation rules that supersede the Treasury's research and experimentation expense allocation regulation for purposes of determining taxable income from U.S. and foreign sources.

Effective Date

The provision extends the application of the Code section 864(f) so that it applies to research expenses paid or incurred during the taxpayer's first four taxable years beginning after August 1, 1989, and on or before August 1, 1993. Thus, under the provision, Code section 864(f) applies to the remainder of the year covered by the 1991 Act as well as to the subsequent year.

3. Extension of Low-Income Housing Credit (sec. 313 of the bill and sec. 42 of the Code)

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 of existing housing that is substantially rehabilitated (e.g., costs other than rehabilitation expenditures), the credit has a present value of 30 percent of qualified costs. Generally, the 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 generally is 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.

Explanation of Provision

The bill extends the low-income housing credit for 18 months, through December 31, 1993.

4. Extension of Targeted Jobs Tax Credit (sec. 314 of the bill and sec. 51 of the Code)

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.

Explanation of Provision

The provision would extend the targeted jobs tax credit for 18 months, through December 31, 1993.

5. Extension of Solar and Geothermal Investment Credit (sec. 315 of the bill and sec. 48 of the Code)

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.[2]

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.

Explanation of Provision

The provision would extend the business credits for solar and geothermal property for eighteen months, through December 31, 1993.

6. Qualified Small-Issue Bonds (sec. 316 of the bill and sec. 144 of the Code)

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

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[2] 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)).

land; however, no more than $62,500 of the bond proceeds may be used to finance used farm equipment.

Qualified small-issue bonds, like most 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.

Explanation of Provision

The bill extends authority to issue first-time farmer bonds for 18 months, through December 31, 1993.

7. Qualified Mortgage Bonds (sec. 317 of the bill and secs. 143 and 25 of the Code)

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 home buyers 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 MCC-recipient's principal residence. MCCs are subject to the same targeting requirements as QMBs. MCCs also are subject to recapture rules like those applicable to QMBs.

Expiration

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

Explanation of Provision

The bill extends authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs for 18 months, through December 31, 1993.

8. Expenses for Drugs for Rare Conditions (sec. 318 of the bill and sec. 28 of the Code)

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.

Explanation of Provision

The provision would extend permanently the orphan drug tax credit.

Subtitle B--Provisions Relating to Enterprise Zones (secs. 321-330 of the bill; secs. 1016, 56, and 62 of the Code; and new secs. 7880 and 1391-1394 of the Code)

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.

Explanation of Provision

The provisions 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.

Effective Date

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

Subtitle C--Excise Tax Provisions

1. Repeal of Luxury Excise Tax on Boats and Aircraft (sec. 341 of the bill and secs. 4002-4004 of the Code)

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.

Explanation of Provision

The provision would repeal the excise tax imposed on boats, yachts, and airplanes.

Effective Date

The repeal would be effective for sales on or after February 1, 1992.

2. Repeal of Exemption for the Use of Diesel Fuel in Pleasure Boats (sec. 342 of the bill and secs. 4041, 4092, and 9503 of the Code)

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; (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.

Explanation of Provision

The bill imposes 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 will be retained in the General Fund.

Effective Date

The provision is effective after June 30, 1992.

3. Additional Services Subject to Communications Excise Tax; Repeal of Exemption for Certain Coin-Operated Telephone Services (secs. 343 and 344 of the bill and secs. 4252 and 4253 of the Code)

Present Law

A three-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 private communications systems, both local or long distance.

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, and certain calls from coin-operated telephones.

Explanation of Provision

The bill extends the three-percent communications excise tax to amounts paid for long-distance digital transmission of data on private communications systems used primarily for such transmissions.

The bill also repeals the exemption for coin-operated telephone service.

Effective Date

Both provisions are effective after June 30, 1992.

Subtitle D--Provisions Related to Retirement Savings and Pension Distributions (secs. 351-359 of the bill and secs. 402, 101, 55, 62, 72, 219, 292, 401, 403, 406, 407, 408, 414, 415, 457, 691, 871, 877, 1441, 3121, 3306, 3405, 4973, 4908A, 7701, 404, and 411 of the Code)

1. Taxability of beneficiary of qualified plan

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.

Explanation of Provision

The bill repeals 5-year forward income averaging for lump-sum distributions and phases out the 1986 Act transition rules over a number of years. In 1992, the 1986 Act rules apply to 100 percent of any lump-sum distribution. In 1993, the rules apply to 70 percent of any lump-sum distribution. In 1994, the rules apply to 35 percent of any lump-sum distribution. In 1995, the rules apply to 20 percent of any lump-sum distribution. In 1993, the rules apply to 10 percent of any lump-sum distribution.

The bill also repeals the special treatment of net unrealized appreciation in employer securities.

The bill permits 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 cannot be rolled over.

Effective Date

The provisions generally are effective for years beginning after December 31, 1991. However, distributions made before February 1, 1992, are taxed in accordance with the law in effect prior to the amendments made by the provisions.

2. Simplified method for taxing annuity distributions under certain employer plans

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.

Explanation of Provision

The provision repeals the exclusion from gross income of up to $5,000 of employer-provided death benefits and replaces the general rule for calculating the taxable portion of a distribution with the simplified method currently provided in IRS Notice 88-118.

Effective Date

The provision is effective for annuity starting dates on or after February 1, 1992.

3. Requirement that qualified plans include optional trustee-to-trustee transfers of eligible rollover distributions

Present Law

Under present law, a qualified plan making a distribution that is eligible for rollover treatment may, but is not required to, offer the participant the option of having the distribution transferred directly to an IRA or another qualified plan.

Explanation of Provision

Under the provision, a qualified plan making a distribution that is eligible for rollover is required to offer the participant the option of having the distribution transferred directly to an IRA, or to a qualified defined contribution plan the terms of which permit the acceptance of rollover distributions.

Effective Date

The provision is effective for plan years beginning on or after February 1, 1992.

4. Salary reduction arrangements of simplified employee pensions

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.

Explanation of Provision

The provision provides that an employer that (1) at any time during the preceding year employed no more than 100 employees who were eligible (or who would have been eligible if a plan had been maintained) to participate and (2) maintains no other retirement plan, may establish a Small Business Model Retirement Plan. The Small Business Model Retirement Plan rules generally replace the present-law rules for salary reduction SEPs.

Under a Small Business Model Retirement Plan, an employer is required to contribute 1 percent of pay (not in excess of $100,000) to an account with respect to each eligible employee. In addition, employees can elect to contribute up to $3,000 to their accounts, subject to the overall limitations on contributions and benefits under qualified retirement plans. The employer is 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.

Effective Date

The provision generally is effective for years beginning after December 31, 1991. However, the provision does not apply to a SEP that was in effect on the date of enactment and that maintained a salary reduction arrangement on such date, unless the employer elects to have the proposal apply for any year and all subsequent years.

5. Tax-exempt organizations eligible under section 401(k)

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.

Explanation of Provision

The provision allows all tax-exempt employers to maintain qualified cash or deferred arrangements for their employees. State and local governments continue to be subject to present law.

Effective Date

The provision is effective for years beginning on or after February 1, 1992.

6. Duties of sponsors of certain prototype plans

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.

Explanation of Provision

The provision permits 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 provision also permits 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.

Effective Date

The provision is effective on the date of enactment.

7. Simplification of nondiscrimination tests applicable under sections 401(k) and 401(m)

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 highly 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 "alternative limitation"). 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 (the ACP test) also applies to employer matching contributions and after-tax employee contributions. A multiple use test generally prohibits use of the alternative limitation to pass both the ADP and ACP test.

Explanation of Provision

Under the provision, the special nondiscrimination test applicable to elective deferrals under a qualified cash or deferred arrangement is modified in two ways.

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

Second, the provision allows 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 can defer is (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 are made to the nondiscrimination test applicable to employer matching and after-tax employee contributions.

In addition, the prohibition against multiple use of the alternative limitation is repealed.

Effective Date

The provision is effective for plan years beginning on or after February 1, 1992.

8. Definition of highly compensated employee

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).

Explanation of Provision

The provision amends the definition of a highly compensated employee to include any employee who (1) at any time during the preceding year was a 5-percent owner or received compensation from the employer in excess of $50,000 (indexed; $60,535 in 1991); or (2) during the current year is (i) a 5-percent owner or (ii) in the top 100 employees by compensation and receives compensation from the employer in excess of $50,000 (indexed; $62,345 in 1992). If no employee qualifies as highly compensated under this definition, then the employee with the highest compensation is treated as a highly compensated employee.

The provision also repeals the family aggregation rules.

Effective Date

The provision is effective for years beginning on or after February 1, 1992.

9. Elimination of special vesting rules for multiemployer plans

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.

Explanation of Provision

The provision repeals the special vesting rule for multiemployer plans. Multiemployer plans are required to comply with the vesting schedules applicable to other qualified plans.

Effective Date

The provision is effective for plan years beginning on or after the earlier of (1) the later of January 1, 1993, or the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates, or (2) January 1, 1995, with respect to participants with an hour of service after the effective date.

Subtitle E--Other Provisions

Part I--Provisions Relating to Charitable Contributions

1. The Alternative Minimum Tax (Sec. 361 of the bill and sec. 57 of the Code)

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.[3] 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.

Explanation of Provision

The provision 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.

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[3] 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.

Effective Date

The repeal would be effective for contributions made in calendar years ending on or after December 31, 1992.

2. Allocation and Apportionment (sec. 362 of the bill and sec. 864 of the Code)

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.[4] 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.[5]

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[4] Treas. Reg. sec. 1.861-8(e)(9)(iv).

[5] 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.

Explanation of Provision

For purposes of computing the foreign tax credit and making related computations, the provision would allocate all deductions for charitable contributions to U.S. source income.

Effective Date

The provision would be effective for contributions made in calendar years ending on or after December 31, 1992.

3. Information Reporting of Large Donations (sec. 363 of the bill and new sec. 6050P of the Code)

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[6], and an authorized representative of the donee charity also must sign 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.[7]

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[6] 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.

[7] 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

(Footnote continued)

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.[8]

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

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[7](continued)
taxpayer identification number (TIN) of the donor, the amount received on the disposition, and certain other information about the disposed property (sec. 6050L).

[8] 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 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).

for property or a service furnished by the organization to the payor.[9] 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.[10] 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.[11]

Explanation of Provision

The provision 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 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 provision 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.

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[9] 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.

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

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

Effective Date

The provision would apply to contributions made on or after July 1, 1992.

Part II--Other Provisions

1. Extend Medicare Hospital Insurance (HI) Coverage to All State and Local Employees (sec. 371 of the bill; sec. 3121 of the Code; and sec. 210 of the Social Security Act)

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.

Explanation of Provision

The provision 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.

Effective Date

This provision would be effective on July 1, 1992.

2. Conform Tax Accounting to Financial Accounting for Securities Dealers (sec. 372 of the bill; sec. 471 and new sec. 475 of the Code)

Present Law

A taxpayer that is a dealer in securities is required for Federal income tax purposes to maintain an inventory of securities held for sale to customers. 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.

Explanation of Provision

The bill conforms 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.

Effective Date

The bill applies to taxable years ending on or after December 31, 1992. Any increase in inventory required by this change in method of accounting is included in gross income ratably over 10 taxable years.

3. Disallowance of Interest Deductions on Corporate Owned Life Insurance (sec. 373 of the bill and sec. 264 of the Code)

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.

Explanation of Provision

The bill denies a deduction for interest paid or incurred on indebtedness with respect to any life insurance contract that is owned by a taxpayer and that covers the life of any individual who is an officer or employee of, or is financially interested in, any trade or business carried on by the taxpayer.

Effective Date

The bill applies to interest incurred on or after February 1, 1992.

4. Clarification of Treatment of Certain FSLIC Assistance (sec. 374 of the bill and secs. 165, 166, 585, and 593 of the Code)

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 and Miscellaneous Revenue Act of 1988 (TAMRA), thrift institutions generally were required to reduce certain tax attributes by one-half the amount of financial assistance received from the FSLIC pursuant to certain acquisitions 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 concludes 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.[12]

Explanation of Provision

Under the provision, 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 in determining the worthlessness of that debt.

Effective Date

The provision 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.

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[12] 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.

5. Equalizing Tax Treatment of Large Credit Unions and Thrifts (sec. 375 of the bill and secs. 501, 591, and 593 of the Code)

Present Law

Federally chartered and State chartered credit unions are exempt from Federal income tax regardless of whether their income is retained or distributed. 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).

Explanation of Provision

The provision would repeal the tax exemption of credit unions that have assets with an adjusted basis 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.

Effective Date

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

6. Treatment of Annuities Without Life Contingencies (sec. 376 of the bill and sec. 72 of the Code)

Present Law

The undistributed investment income ("inside buildup") earned under 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.

Explanation of Provision

The bill retains the present-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 is taxed as earned. The distinction between annuities is based on whether there exists a substantial risk of loss of investment if the annuitant were to die prematurely. A contract generally is to be considered an annuity contract for Federal income tax purposes only if payments are guaranteed (1) for a period of time that does not exceed one-third of the annuitant's remaining life expectancy on the annuity starting date, and (2) for an amount that does not exceed one-third of the annuity's cash value on the annuity starting date (or date of death, if earlier). The bill does not apply to pension annuities and annuities that are part of structured settlements.

Effective Date

The bill applies to annuity contracts entered into on or after the date of enactment.

7. Expansion of 45-Day Interest-Free Period (sec. 377 of the bill and sec. 6611 of the Code)

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.

Explanation of Provision

The provision would extend the 45-day processing rule to all returns, as well as to amended returns and claims for refunds.

Effective Date

This provision would be effective for returns filed on or after July 1, 1992.

8. Use of Taxpayer Information by 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).

Explanation of Provision

The provision would permanently extend this authority to disclose tax information.

Effective Date

The provision would be effective on the date of enactment.

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PRELIMINARY
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II. - H.R. 4210 -

ESTIMATED BUDGET EFFECTS OF REVENUE PROVISIONS
IN THE PRESIDENT'S FISCAL YEAR 1993 BUDGET
WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS

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. Promote retirement saving and simplify taxation of pension distributions	0.5	0.5	-0.9	-0.5	-0.2	0.2	-0.5
9. Expand public transit exclusion to $60 per month (3)	(2)	(2)	(2)	-0.1	-0.1	-0.1	-0.2
10. Modify taxation of annuities without life contingencies (4)	(5)	0.1	0.2	0.3	0.5	0.8	1.9
11. 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 (6)	(2)	(2)	(2)	(2)	(2)	(2)	-0.2
5. Establish enterprise zones (7)	--	-0.1	-0.4	-0.8	-1.0	-1.0	-3.3
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
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	(5)	0.1	0.1	0.1	0.1	0.1	0.4

Provision	1992	1993	1994	1995	1996	1997	1992-97
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 Provision							
1. Extend 45-day processing rule to all returns (8)	(5)	0.2	0.2	0.2	0.3	0.3	1.2
F. Other Tax Provisions							
1. Repeal luxury excise tax on airplanes and boats (9)	(2)	(2)	(2)	(2)	(2)	(2)	-0.2
2. Repeal diesel fuel exemption for boats (9)	(5)	(5)	(5)	(5)	(5)	(5)	0.2
3. Expand telephone tax (digital); coin-operated telephones	(5)	(5)	(5)	(5)	0.1	0.1	0.2
4. Extend Medicare (HI) coverage to State and local employees (9)(10)	0.4	1.7	1.7	1.7	1.6	1.6	8.7
G. Withholding Table Changes	--	--	--	--	--	--	---
GRAND TOTALS	**-5.4**	**-2.6**	**-9.0**	**-11.7**	**-12.3**	**-12.8**	**-53.7**

Joint Committee on Taxation

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

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

(5) Gain of $50 million or less.

(6) 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.

(7) Based on information provided by the Department of Housing & Urban Development regarding probable size and economic characteristics of zones to be designated.

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

(9) Net of income tax offsets.

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