DESCRIPTION OF CHAIRMAN'S MARK: TAX PROPOSALS RELATING TO WORKING FAMILIES, LONG-TERM ECONOMIC GROWTH, AND TAX FAIRNESS

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

On March 3, 1992

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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JCX-7-92

ERRATA FOR JCX-7-92

o On page 20, a new paragraph should be inserted before Effective Date, to read as follows:

Youth Training Program

The proposal would establish an independent national board to develop a system of industry-based, occupational proficiency standards and certifications of mastery for occupations within each major industry, and occupations that involve more than one industry, for which no recognized training standards currently exist.

o On page 49, first sentence under Description of Proposal should read as follows:

For purposes of computing the AMT preference for IDCs of an independent oil and gas producer, the proposal would raise the 65-percent net oil and gas income offset to 70 percent.

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of Chairman Bentsen's Mark on tax proposals relating to working families, long-term economic growth, and tax fairness. The tax proposals are scheduled for markup by the Senate Committee on Finance on March 3, 1992.

(Separate Joint Committee on Taxation staff documents are prepared describing proposals relating to pension simplification, other tax simplification, and Taxpayer Bill of Rights.)

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Chairman's Mark: Tax Proposals Relating to Working Families, Long-Term Economic Growth, and Tax Fairness (JCX-7-92), March 3, 1992.

DESCRIPTION OF TAX PROPOSALS

A. Provisions for Fair Treatment of Working Families

1. Tax Credit for Taxpayers with Children under Age 16

Present Law

Present law provides no income tax credit to taxpayers on the basis of whether taxpayers have a child residing with them. However, present law permits a personal exemption deduction from gross income for each of the taxpayer's dependent children. For 1992, the amount of this deduction is $2,300 for each exemption claimed. This exemption amount is adjusted annually for inflation.

In addition, low-income workers with children are able to claim a refundable earned income tax credit (EITC) of up to 17.6 percent (18.4 percent for taxpayers with more than one qualifying child) of the first $7,520 of earned income for 1992. The maximum amount of credit for 1992 is $1,324 ($1,384 for taxpayers with more than one qualifying child). This maximum credit is reduced by 12.57 percent (13.14 percent for taxpayers with more than one qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,840. The EITC is totally phased out for workers with earned income (or adjusted gross income, if greater) over $22,370. The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

	One qualifying child--		Two or more qualifying children--	
Year	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

Description of Proposal

The proposal would provide a $300 income tax credit for each qualifying child of the taxpayer. A "qualifying child" would be defined as a child under age 16 who resided with the taxpayer for more than 6 months during the taxable year. The tax credit would offset regular tax liability and would not be refundable (though through the offset of tax liability, the tax credit could act to increase the amount of refund from the earned income tax credit that a taxpayer might receive). The credit amount would be indexed for inflation. In addition, the credit would be phased out ratably for higher-income taxpayers with adjusted gross income between $50,000 and $70,000.

Effective Date

The proposal would be effective January 1, 1992.

2. Simplification and Expansion of Earned Income Tax Credit

Present Law

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC) of up to 17.6 percent (18.4 percent for taxpayers with more than one qualifying child) of the first $7,520 of earned income for 1992. The maximum amount of credit for 1992 is $1,324 ($1,384 for taxpayers with more than one qualifying child). This maximum credit is reduced by 12.57 percent (13.14 percent for taxpayers with more than one qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,840. The EITC is totally phased out for workers with earned income (or adjusted gross income, if greater) over $22,370. The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

	One qualifying child--		Two or more qualifying children--	
Year	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

A supplemental young child credit is available to taxpayers with qualifying children under the age of one year. This young child credit rate is 5 percent and the phase-out rate is 3.57 percent. It is computed on the same income base as the ordinary EITC. The maximum supplemental young child credit for 1992 is $376. If a taxpayer claims the supplemental young child credit, the child that qualifies the taxpayer for such credit is not a qualifying individual for purposes of the dependent care tax credit (sec. 21).

A supplemental health insurance credit is available to taxpayers who provide health insurance coverage for their qualifying children. This health insurance credit rate is 6 percent and the phase-out rate is 4.285 percent. It is

computed on the same income base as the ordinary EITC, but the credit claimed cannot exceed the out-of-pocket cost of the health insurance coverage. In addition, the taxpayer is denied an itemized deduction for medical expenses of qualifying insurance coverage up to the amount of credit claimed. The maximum supplemental health insurance credit for 1992 is $451.

Description of Proposal

The proposal would increase the basic EITC rate for taxpayers with two or more qualifying children as shown in the following table.

	One qualifying child--		Two or more qualifying children--	
Year	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	20.15	14.39
1993	18.5	13.21	21.25	15.17
1994 and after	23.0	16.43	26.75	19.10

The proposal would permit taxpayers to include all health insurance expenses as medical expenses, subject to the 7.5 percent of adjusted gross income floor on deductible medical expenses, regardless of whether these expenses had been used to claim the health insurance component of the EITC. The proposal would also permit a self-employed taxpayer to claim the allowable deduction for health insurance costs and to use the full amount of these expenses that are related to coverage of dependent children to claim the health insurance component of the EITC.

The proposal would repeal the supplemental young child credit.

Effective Date

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

3. Extension of Targeted Jobs Tax Credit

Present Law

Tax credit

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

The credit generally is equal to 40 percent of up to $6,000 of qualified first-year wages paid to a member of a targeted group. Thus, the maximum credit generally is $2,400 per individual. With respect to economically disadvantaged summer youth employees, however, the credit is equal to 40 percent of up to $3,000 of wages, for a maximum credit of $1,200.

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

Authorization of appropriations

Present law authorizes appropriations for administration 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.

Description of Proposal

The proposal would extend the targeted jobs tax credit and the authorization for appropriations for 18 months, through December 31, 1993.

Effective Date

The proposal would be effective on the date of enactment.

B. Provisions for Long-Term Economic Growth

1. Individual Retirement Arrangements (IRAs)

Present Law

Under present law, certain individuals are allowed to deduct contributions (up to the lesser of $2,000 or 100 percent of the individual's compensation or earned income) to an individual retirement arrangement (IRA). The amounts held in an IRA, including earnings on contributions, generally are not included in taxable income until withdrawn.

The $2,000 deduction limit is phased out over certain adjusted gross income (AGI) levels ($25,000 for individuals, $40,000 for joint filers) if the individual or the individual's spouse is an active participant in an employer-sponsored retirement plan. An individual may make nondeductible IRA contributions (up to the $2,000 or 100 percent of compensation limit) to the extent the individual is not permitted to make deductible IRA contributions.

Description of Proposal

The provision would restore the deductibility of IRA contributions for all taxpayers under the rules in effect prior to the Tax Reform Act of 1986 and would provide for the indexing of the limits on contributions to IRAs, in increments of $500.

In addition, the provision would permit nondeductible contributions to new special IRAs. Withdrawals from a special IRA would not be includible in income if attributable to contributions that had been held by the special IRA for at least 5 years. The limits on contributions to deductible IRAs and special IRAs would be coordinated. Furthermore, the limit on contributions to deductible IRAs and special IRAs would be coordinated with the limit on elective deferrals to certain tax-deferred plans (e.g., sec. 401(k) plans). Thus, for example, in no case could the sum of contributions to an IRA, contributions to a special IRA, and elective contributions to a 401(k) plan exceed the limit on elective deferrals ($8,728 in 1992).

The provision would permit transfers from deductible IRAs to special IRAs without imposition of the 10-percent tax on early withdrawals. The amount transferred to a special IRA generally would be includible in income in the year withdrawn. However, in the case of a transfer before January 1, 1994, the transferred amount would be includible in income ratably over a 4-taxable year period.

The provision would allow withdrawals from an IRA and from amounts attributable to elective deferrals under (1) a section 401(k) plan, (2) a tax-sheltered annuity (sec. 403(b) annuity, or (3) a section 501(c)(18) plan without imposition of the 10-percent additional income tax on early withdrawals to the extent the amount withdrawn is used to pay qualified acquisition, construction, or reconstruction costs with respect to a principal residence of a first-time homebuyer who is the taxpayer, the taxpayer's spouse, or the taxpayer's child or grandchild. A first-time homebuyer would be defined as any individual (and if married, such individual's spouse) who had no present interest in a principal residence during the 2-year period prior to the purchase of a home.

The waiver of the 10-percent additional tax on early withdrawals would also apply to the extent distribution did not exceed qualified higher education expenses. Qualified higher educational expenses means tuition, fees, books, supplies, and equipment required for the enrollment of or attendance of the taxpayer, the taxpayer's spouse, or the taxpayer's child or grandchild at a college, university, or post-secondary vocational school. The amount of qualified higher educational expenses for any taxable year would be reduced by any amount excludable from gross income under the provision in the Code pertaining to U.S. education savings bonds.

The provision would extend to IRAs the present-law exception to the 10-percent additional income tax for distributions from qualified retirement plans used to pay deductible medical expenses. For purposes of the medical expense exception (with regard to both IRAs and qualified retirement plans), a child, grandchild, or ancestor of the taxpayer would be treated as a dependent of the taxpayer in determining whether medical expenses are deductible.

Finally, the provision would provide that the present-law rule permitting penalty-free IRA withdrawals after an individual reaches 59-1/2 would not apply in the case of amounts attributable to contributions made during the previous 5 years. Thus, IRA contributions generally would have to remain in the account for at least 5 years to avoid withdrawal penalties. This restriction would only apply to contributions (and earning allocated thereto) that are made after December 31, 1991. Moreover, for purposes of applying the rule, distributions would be treated as having been made first from the earliest contribution (and earnings) remaining in the account, and then from other contributions in the order in which made.

Effective Date

The provision generally would apply to taxable years beginning after December 31, 1992. However, the rule permitting penalty-free withdrawals in certain cases would be effective for taxable years beginning after December 31, 1991. In addition, the rule permitting transfers from deductible IRAs to special IRAs would be effective for taxable years beginning after December 31, 1991. Thus, special IRAs could be established and maintained in taxable years beginning before January 1, 1993, only with funds transferred from a deductible IRA.

2. Income-Dependent Education Assistance: Self-Reliance Loans

Present Law

The Department of Education subsidizes student loans under the Guaranteed Student Loan (GSL) and Parent Loans to Undergraduate Students (PLUS) programs. These loan programs generally are available for certain postsecondary educational expenses, regardless of a student's financial need. The subsidies provided under the GSL and PLUS programs generally take three forms. First, the Department of Education guarantees repayment of qualified student loans made by banks. Second, the Department pays special allowance payments as an interest subsidy on qualifying student loans so that student borrowers are required to pay less interest on the loans. Third, with so-called "Stafford" loans, the Department pays an additional interest subsidy on qualified loans while the student is attending school.[1]

In addition, through the National Direct Student Loan (NDSL) program, the Federal government has made available revolving, direct-loan funds at certain participating educational institutions.[2] Such loans (commonly referred to as "Perkins loans") are available only to low-income students with significant demonstrated financial need. The schools participating in the NDSL program are responsible for collecting amounts due from student borrowers.

Federal agencies are authorized to notify the IRS that a person owes a past-due, legally enforceable debt (such as a delinquent student loan) to that agency. The IRS then is required to reduce the amount of any Federal tax refund due such person by the amount of the debt and pay that amount to the agency. The refund offset program applies with respect to debts of individuals and corporations (sec. 6402(d)).

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[1] In the case of Supplemental Loans for Students ("SLS" loans) there is no in-school interest subsidy provided by the Federal government. SLS loans are available only to independent students.

Stafford loans generally are limited to $3,500 for freshmen and sophomores, $5,500 for juniors and seniors, with a total undergraduate cap of $23,000. SLS loans generally are limited to $4,000 for freshmen and sophomores, $5,000 for juniors and seniors, with a total undergraduate cap of $23,000.

[2] Currently, a total lending pool of about $850 million is available at over 3300 participating schools.

Description of Proposal

In general

The proposal would create a program ("Income-Dependent Education Assistance") of direct loans ("Self-Reliance Loans") for higher education expenses. The Secretary of Education would make payments to participating institutions on the basis of estimated borrowing needs of the students at such institution. Eligible students who borrow funds under the program would have an account established with the Secretary of Education to record interest on and repayment of the Self-Reliance Loans. Such borrowers would make income-dependent repayments through the income tax system by means of a specially computed addition to tax that represents both principal and interest on the loan.

Eligible students

Eligible students would be United States citizens at least 17 years old, but not yet 51 years old, who are enrolled at a participating institution (which, for fiscal years 1994-1997, are selected by the Secretary of Education). Eligible students would be able to receive Self-Reliance Loans without regard to financial need. Notwithstanding any other provision of law, an eligible student would not receive a Self-Reliance Loan in any fiscal year unless such student's eligibility for assistance under section 428 and subpart 1 of part A of the Higher Education Act had been assessed.

Limits on amounts borrowed

In general

The maximum amount of Self-Reliance Loans that could be borrowed by a student in his or her lifetime would be $30,000, with no more than $25,000 of that amount for undergraduate education. A student could receive a Self-Reliance Loan in the amount of no more than $5,000 per fiscal year in the case of an undergraduate student and no more than $15,000 per fiscal year in the case of a graduate student.

Coordination with other Federal loan programs

The combined maximum amount of loans a student could borrow under the Income-Dependent Education Assistance program, Part B (Stafford and Perkins loans), and Part E (Supplemental Loans for Students) of the Higher Education Act of 1965 could not exceed $52,000 for a dependent undergraduate, $62,000 for an independent undergraduate[3] who borrows at least $10,000 in Self-Reliance Loans, and $115,000 for a graduate student.

Limit by cost of attendance

In any fiscal year, a student could not receive Self-Reliance Loans in an amount greater than such student's qualified education expenses (tuition, fees, books, supplies, and reasonable living expenses away from home) to attend a postsecondary school (as defined in section 481(a) of the Higher Education Act of 1965) less any other Federal educational financial assistance received by such student.

Interest rate on loans

The interest rate on a Self-Reliance Loan would be established at the time of issuance and would be equal to the average of the interest rates on the 10-year and 30-year Treasury bonds. The Secretary of Education would establish the interest rate on Self-Reliance Loans at the same time (and with the same frequency) as is done for the Supplemental Loans for Students program.

Repayment procedure

In general

Repayment on an individual's Self-Reliance Loan obligations would be collected through the individual income tax. For a taxpayer in repayment status, the taxpayer's income tax liability generally would be increased by the applicable Self-Reliance Loan repayment rate multiplied by the taxpayer's adjusted gross income (AGI).[4] This repayment would be treated as a tax imposed by section 1 of the Code except for purposes of determining the amount of any tax credit or the amount of minimum tax.

The applicable repayment rate would be fixed at the time the taxpayer first enters repayment status and would depend upon the taxpayer's amount of outstanding Self-Reliance Loan

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[3] As determined in section 428A of the Higher Education Act of 1965.

[4] In the case of a married individual whose spouse has not received a Self-Reliance Loan and who files a joint return, the income tax liability on the joint return would be increased by the individual's repayment rate multiplied by the AGI on the joint return. In the case of a married individual whose spouse has not received a Self-Reliance Loan and who files a separate return, such individual's income tax liability would increased by the individual's repayment rate multiplied by the sum of the AGI of that individual and the AGI of the individual's spouse (from the spouse's separate return).

indebtedness. Students with "high" indebtedness (as determined by the Secretary of Education) would have a repayment rate of 7 percent. Students with "moderate" indebtedness would choose between a repayment rate of 5 percent or 7 percent. Students with "low" indebtedness would choose among a repayment rate of 3 percent, 5 percent, or 7 percent. The Secretary of Education would make the determination of "low" and "moderate" indebtedness ranges so that the average borrower in each indebtedness status would be projected to repay the Self-Reliance Loan over a similar number of years as the average borrower with "high" indebtedness status.

A borrower would be in repayment status through the taxable year during which the loan obligation is repaid or, if earlier, 25 taxable years after the borrower was last enrolled in an institution of higher education on at least a half-time basis.

A borrower would be able to prepay all or part of a Self-Reliance Loan without penalty.

Repayment tax payments received on or before the due date (without regard to any extension) for filing of the income tax return for a given taxable year would be credited to the taxpayer's Self-Reliance Loan account as if received on the last day of the previous taxable year. Repayment tax payments received after the due date (without regard to any extension) for filing of the income tax return for a given taxable year would be credited to the taxpayer's Self-Reliance Loan account as if received on the last day of the following taxable year.

Exceptions for at least half-time students

A borrower would not be in repayment status for any taxable year during which either (1) the borrower was enrolled as at least a half-time student in an institution of higher education for 7 months of such taxable year or (2) the borrower was enrolled as at least a half-time student in an institution of higher education for final 3 months of such taxable year and such taxable year was the first in which the borrower was such a student (e.g., the borrower was a freshman).

A borrower would be able to defer payment of interest on a Self-Reliance Loan while he or she attends an institution of higher education on at least a half-time basis.

Exception for borrowers not required to file a tax return

No repayment of a Self-Reliance Loan would be required in any year in which the borrower is not required to file an income tax return.

Discharge of liability of the borrower

In general.--The Secretary of Education would discharge the liability to repay a Self-Reliance Loan in the event of the death or total permanent disability of a borrower. If a loan were discharged because of death or disability of the borrower or because of expiration of the 25-year repayment status period, the borrower (or his or her estate) would not be considered to have discharge of indebtedness income (under Code section 108(f)).

Bankruptcy.--A Self-Reliance Loan would not be dischargeable in bankruptcy. The Secretary of Treasury, however, could postpone payment on past-due amounts owed by bankrupt individuals.

Delinquent taxpayers

Borrowers who are delinquent in repaying their Self-Reliance Loan and who subsequently make interest payments to the Secretary of the Treasury on their underpayment would be entitled to have interest that is properly allocable to such loans credited by the Secretary of Education to their Self-Reliance Loan repayment.

Administration of the loan program

The Secretary of the Treasury would enter into an agreement with the Secretary of Education to process information on repayments and credit such repayments to the Department of Education.

The Secretary of the Treasury would make appropriate provisions to require borrowers to make Self-Reliance Loan repayments through payroll withholding and estimated tax payments to the extent practicable and would determine the liability of borrowers for incorrect withholding according to rules on estimated tax payments.

The Secretary of Education would develop a central data system to administer the Income-Dependent Education Assistance program. Such data system would provide borrowers with information on their Self-Reliance Loan balance and on prepayment options. Not later than January 1 of each year, the Secretary of Education would certify to the Secretary of the Treasury (1) a list of borrowers in repayment status for that year, (2) the sum of each such borrower's total

principal amount of such loans plus any accrued interest minus the sum of any amounts collected from such borrower, and (3) the percentage of income each borrower has agreed to repay. A copy of such certification with respect to a borrower would be sent to such borrower.

Demonstration program

In general

The Secretary of Education would select institutions of higher education for participation in the Self-Reliance Loan program from those institutions submitting applications that are eligible to participate in part B loan programs. Not later than May 1, 1993, the Secretary would select not more than 500 institutions to participate in the program. The participating institutions would be chosen so as to represent a cross-section by educational sector, length of academic program, default experience, annual loan volume, highest degree offered, enrollment size, and geographic location. The Secretary would also select participating institutions in such a manner that the projected volume of student borrowing under the demonstration program would not exceed the following amounts:

$450,000,000 in fiscal year 1994
$550,000,000 in fiscal year 1995
$650,000,000 in fiscal year 1996
$900,000,000 in fiscal year 1997.

Each institution wishing to offer an Income-Dependent Education Assistance program would be required to submit an application to the Secretary of Education and, if accepted, enter into an agreement with the Secretary of Education for receipt of funds. Each participating school would agree to follow procedures specified by the Secretary of Education in consultation with the Secretary of the Treasury in disbursing such loans; to accept liability stemming from mismanagement of loans or false origination of loans; to provide the Secretary of Education at least once a month with a list of Self-Reliance Loan participants and any change in their enrollment status; and to counsel borrowers on their repayment options and their obligations.

The Secretary of Education would have the same authority to limit, suspend, or terminate an institution's participation in the Income-Dependent Education Assistance program as applies to an institution's participation in loan programs under Part B of the Higher Education Act of 1965, and could also impose additional regulations or criteria for participation. The demonstration program would conclude at the end of fiscal year 1997.

Administrative costs

There would be available to the Secretaries of Education and the Treasury for administrative costs amounts not to exceed the following:

Fiscal year	Treasury	Education
1992	$ 0	$ 0
1993	$1,000,000	$40,000,000
1994	$7,500,000	$20,000,000
1995	$4,500,000	$20,000,000
1996	$3,600,000	$20,000,000
1997	$4,000,000	$20,000,000

Evaluation and reporting

Beginning one year after enactment, the Secretary of Education, in consultation with the Secretary of the Treasury, would make annual reports to Congress describing and evaluating the implementation and administration of the Income-Dependent Education Assistance program and identifying problems that require legislative action.

Not later than January 1, 1997, the Secretary of Education, in consultation with the Secretary of the Treasury, would make a report to the Senate Committee on Labor and Human Resources and the House Committee on Education and Labor analyzing the administrative capacity of the Department of Education and any other Federal agency to operate this program; the administrative burden and costs imposed on the Department of Education and any other Federal agency by this program; the accuracy of information provided by the Secretary of Education; the administrative and financial factors that would affect the ability of all schools to participate in the program; the impact of this program on repayments, delinquencies and defaults under all federal student loan programs; and any other relevant information. The report would also publish the tuition and cost of attendance at each institution participating in the program and analyze changes in those costs compared to changes occurring at institutions not participating in the program. The report would examine the feasability of integrating the Income-Dependent Education Assistance program with a national service program. The report would also make recommendations for legislative actions necessary to implement the Income-Dependent Education Assistance program at all eligible institutions of higher education.

Effective Date

The proposal would be effective upon date of enactment. Amendments made to the Internal Revenue Code would be effective for taxable years beginning after December 31,

1992. The first Self-Reliance Loans would be issued on or after September 1, 1993.

3. Choice of Credit or Deduction for Interest on Student Loans

Present Law

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest is generally treated as personal interest and thus is not allowable as an itemized deduction from income. There is no tax credit allowed for student loan interest paid by a taxpayer.

Description of Proposal

In general

The provision would allow individuals who have paid interest on qualified education loans to choose either a deduction for such interest or a nonrefundable credit against regular tax liability generally equal to 15 percent of such interest, subject to a maximum credit of $300. In order to qualify for either the deduction or the credit in a given taxable year, the interest must be paid during that taxable year and during the first 48 months (need not be consecutive) that payment on the loan is due. Unused amounts of credit could not be carried forward or backward to other taxable years.

A qualified education loan generally is any indebtedness incurred to pay for qualified higher education expenses of the taxpayer or the taxpayer's spouse or dependents with respect to higher education institutions and certain area vocational education schools (i.e., eligible educational institutions defined in Code section 135(c)(3)) and institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The qualified higher education expenses must be paid or incurred within a reasonable period of time before or after the indebtedness is incurred and must be attributable to education furnished during a period of time that the individual benefiting from the loan proceeds was at least a half-time student. Indebtedness that is used to refinance any indebtedness described in the previous sentence is also treated as a qualified education loan.

Qualified higher education expenses include tuition, fees, books, supplies, and reasonable living expenses while the student lives away from home. At the time the expenses are incurred, the student must be the taxpayer or the taxpayer's spouse or dependent (as defined under Code section 152). Qualified higher education expenses taken into account for the purpose of this credit are reduced by the amount

excluded from gross income under Code section 135 (relating to the redemption of United States savings bonds to pay for higher education expenses) and by the amount of the reduction described in Code section 135(d)(1) (relating to certain scholarships and veterans benefits).

Limitation on claiming deduction

A taxpayer may not claim a deduction for interest on a qualified education loan if the taxpayer claims a deduction for qualified residence interest that is allocable to indebtedness used to pay for qualified higher education expenses of the taxpayer or the taxpayer's spouse or dependent.

Limitations on claiming credit

In general

No credit is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year beginning in the calendar year in which such individual's taxable year begins.

No credit is allowed for interest on any amount of education loan indebtedness for which a deduction is claimed under any other provision.

If the taxpayer is under 23 years old (or, in the case of a joint return, if both spouses are under 23) at the end of the calendar year ending with or within the taxable year, the amount of the credit is not to exceed the taxpayer's regular tax liability multiplied by the ratio of the taxpayer's earned income (defined in Code section 911(d)(2)) to the taxpayer's adjusted gross income.

Credit claimed for interest on borrowing for expenses of taxpayer's dependent

In the case of qualified education loans used to pay the qualified higher education expenses of an individual other than the taxpayer or the taxpayer's spouse, no credit is allowed unless the individual is claimed as a dependent of the taxpayer for that taxable year and the individual is at least a half-time student during that taxable year.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991 and only for loans whose first payments are due after that date.

4. Formation of, and Contributions to, Tax-Exempt Youth Training Organizations

Present Law

In order to qualify as a tax-exempt organization under section 501(c)(3) and be eligible to receive tax-deductible contributions, an organization must be organized and operated exclusively for charitable, educational, or other exempt purposes specified in section 501(c)(3), and no part of the organization's net earnings may inure to the benefit of any private shareholder or individual. Section 501(c) also provides tax-exempt status for other types of organizations (e.g., social welfare organizations and business associations), provided certain requirements are satisfied.

Charitable contributions to organizations described in section 501(c)(3) are allowed as an itemized deduction, subject to certain percentage limitations (sec. 170). In addition, donations to States or political subdivisions are deductible as charitable contributions, provided that the donation is made for exclusively public purposes. Depending on the type of property contributed and the type of the donee organization, the amount of a taxpayer's charitable contribution deduction generally is allowed in an amount up to the contributed property's fair market value. However, special rules provide for an augmented charitable contribution deduction for certain contributions made by corporations of inventory property used for the care of the ill, the needy, or infants, and certain scientific research property donated to educational or scientific organizations (sec. 170(e)(3) and (4)). The deduction allowed for such donations is equal to the corporation's basis in the property plus one-half of the amount of ordinary income that would have been realized if the property had been sold (but in no event may the deduction exceed twice the basis in the contributed property).

Payments made by a taxpayer to a tax-exempt organization are deductible as ordinary and necessary business expenses under section 162, provided that the taxpayer has a reasonable expectation of financial return to his trade or business commensurate with the amount of the transfer. In such a case, a "gift or contribution" has not been made for purposes of section 170.[1]

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[1] See Treas. Reg. sec. 1.170A-1(c)(5); Rev. Rul. 84-110, 1984-2 C.B. 35.

Description of Proposal

Tax-exempt status

The proposal would specifically provide tax-exempt status for certain youth training organizations that are organized and operated solely for the purpose of administering a training program that (1) combines supervised on-the-job training for full-time high school students with theoretical academic instruction, (2) requires student participants be provided broad-based competencies and transferable skills suitable for career progression within the industry or trade in which the student is employed, (3) requires student trainees to be treated as employees for purposes of section 6 of the Fair Labor Standards Amendments of 1989, or section 6 or 14 of the Fair Labor Standards Act of 1938, and (4) prohibits the use of contributions to the organization for actual employment training expenses or compensation of student trainees.

The youth training organization would be required to be controlled by representatives of businesses contributing to the organization, schools participating in the training program, State or local governments, and student trainees.

Augmented deduction

The proposal also would provide an augmented deduction for cash contributions made to a tax-exempt youth training organization. The allowable deduction would be 150 percent of the contributed amount.

Department Studies

The Treasury, Labor, and Education Departments would be directed to report to Congress within three years after enactment on the effects of the proposal and any recommendations for legislative modifications.

Effective Date

The proposal would be effective for taxable years beginning after the date of enactment.

5. Extension of Exclusion for Employer-Provided Educational Assistance

Present Law

An employee's gross income and wages for income and employment tax purposes do not include amounts paid or incurred by the employer for education assistance provided to the employee if such amounts are paid or incurred pursuant to an educational assistance program that meets certain requirements. This exclusion, which expires with respect to amounts paid after June 30, 1992, is limited to $5,250 of educational assistance with respect to an individual during a calendar year.

In the absence of this exclusion, an employee generally would be required to include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to the employee, unless the cost of such assistance qualified as a deductible job-related expense of the employee.

Description of Proposal

The exclusion for employer-provided educational assistance would be extended for 18 months, through December 31, 1993.

Effective Date

The proposal would be effective for taxable years ending after June 30, 1992.

6. Expansion of Educational Savings Bond Provisions

Present Law

Code section 135 provides that interest income earned on a qualified U.S. Series EE savings bond issued after December 31, 1989, is excludible from gross income if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during the taxable year.[1] "Qualified higher education expenses" include tuition and required fees for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at an eligible educational institution. A taxpayer cannot qualify for the interest exclusion by paying for the education expenses of another person (such as a grandchild or other relative) who is not a dependent of the taxpayer.

The exclusion provided by section 135 is phased out for certain higher-income taxpayers. A taxpayer's AGI for the year the bond is redeemed (not the year the bond was issued) determines whether or not the phaseout applies. For taxpayers filing a joint return, the phaseout range is for AGI between $60,000 and $90,000 (adjusted for inflation). For single taxpayers and heads of households, the phaseout range is for AGI between $40,000 and $55,000 (adjusted for inflation).

To prevent taxpayers from effectively avoiding the income phaseout limitation (through the issuance of bonds directly in the child's name), section 135(c)(1)(B) provides that the interest exclusion is available only with respect to U.S. Series EE savings bonds issued to taxpayers who are at least 24 years old.

The interest rate on Series EE savings bonds varies, depending on how long the bonds are held. The interest rate on such bonds held for more than five years is based on the market rate for Treasury outstanding obligations with five years to maturity. Bonds held for less than five years earn interest on a fixed, graduated scale (generally below current rates on comparable Treasury instruments). Interest earned on Series EE bonds is paid when the bonds are redeemed.

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[1] If the aggregate redemption amount (i.e., principal plus interest) of all Series EE bonds redeemed by a taxpayer during the taxable year exceeds the qualified education expenses incurred, then the excludable portion of interest income is based on the ratio that the education expenses bears to the aggregate redemption amount.

Description of Proposal

The proposal would expand the definition of "qualified higher education expenses" under section 135 to include tuition and required fees paid by a taxpayer for the enrollment or attendance of any individual at an eligible educational institution (not simply dependents).

The proposal also would repeal the present-law AGI phaseout limitation under section 135 (and the related rule requiring that bonds be issued to a person who is at least 24 years old). Thus, interest earned on a Series EE savings bond would not be subject to tax regardless of the taxpayer's AGI during the year the bond is redeemed if, during that year, the taxpayer pays for qualified education expenses of any individual and the education expenses exceed the proceeds (principal plus interest) received upon redemption.

Effective Date

The proposal would apply to U.S. Series EE savings bonds issued after December 31, 1989, and redeemed after December 31, 1991.

7. Expansion of 45-Day Interest-Free Period

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 parallel rule for refunds of taxes other than income taxes (i.e., employment, excise, and estate and gift taxes), for refunds of any type of tax arising from amended returns, or for claims for refunds of any type of tax.

If a taxpayer files a timely original return with respect to any type of tax and later files an amended return claiming a refund, and if the IRS determines that the taxpayer is due a refund on the basis of the amended return, the IRS will pay the refund with interest computed from the due date of the original return.

Description of Proposal

The provision provides that no interest is to be paid by the Government on a refund arising from any type of original 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.

A parallel rule applies to amended returns and claims for refunds: if the refund is issued by the 45th day after the date the amended return or claim for refund is filed, no interest is to be paid by the Government for that 45-day period (interest would continue to be paid for the period from the due date of the return to the date the amended return or claim for refund is filed). If the IRS does not issue the refund by the 45th day after the date the amended return or claim for refund is filed, interest would be paid (as under present law) for the period from the due date of the original return to the date the IRS pays the refund.

A parallel rule also applies to IRS-initiated adjustments (whether due to computational adjustments or audit adjustments). With respect to these adjustments, the IRS is to pay interest for 45 fewer days than it otherwise would.

Effective Date

The extension of the 45-day processing rule is effective for returns required to be filed (without regard to extensions) on or after July 1, 1992.

The amended return rule is effective for amended returns and claims for refunds filed on or after July 1, 1992 (regardless of the taxable period to which they relate).

The rule relating to IRS-initiated adjustments is applicable to refunds paid on or after July 1, 1992 (regardless of the taxable period to which they relate).

8. Extend Health Insurance Deduction for Self-Employed Individuals

Present Law

Under present law, the tax treatment of health insurance expenses depends on whether the taxpayer is an employee and whether the taxpayer is covered under a health plan paid for by the taxpayer's employer. An employer's contribution to a plan providing accident or health coverage for the employee and the employee's spouse and dependents is excludable from an employee's income and wages for income and employment tax purposes. 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. The amount of expenses in excess of the deductible amount can be taken into account in determining whether the individual is entitled to deduct medical expenses as an itemized deduction (sec. 213). Thus, such amounts are deductible to the extent that, when combined with other unreimbursed medical expenses, they 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.

Description of Proposal

The proposal would extend and increase the 25-percent deduction for health insurance expenses of self-employed individuals. For 1992, the deduction would be 25 percent of health insurance expenses. For 1993 and 1994, the deduction would be 100 percent of health insurance expenses. The deduction would expire after December 31, 1994.

Effective Date

The proposal would be effective for taxable years ending after June 30, 1992.

9. Increase Base Tax Rate on Ozone-Depleting Chemicals and Expand List of Taxed Chemicals

Present Law

A excise tax is imposed on certain ozone-depleting chemicals. The amount of tax generally is determined by multiplying the base tax rate applicable for the calendar year by an ozone-depleting factor assigned to the chemical. Certain chemicals are subject to a reduced rate of tax for years prior to 1994.

Between 1992 and 1995 there are two base tax rates applicable, depending upon whether the chemicals were initially listed in the Omnibus Reconciliation Act of 1989 or whether they were newly listed in the Omnibus Reconciliation Act of 1990. The base tax rate applicable to initially listed chemicals is $1.67 per pound for 1992, $2.65 per pound for 1993 and 1994, and an additional 45 cents per pound per year for each year thereafter. The base tax rate applicable to newly listed chemicals is $1.37 per pound for 1992, $1.67 per pound for 1993, $3.00 per pound for 1994, $3.10 per pound for 1995, and an additional 45 cents per pound per year for each year thereafter.

The initially listed chemicals are CFC-11, CFC-12, CFC-113, CFC-114, CFC-115, Halon-1211, Halon-1301, Halon-2402. The newly listed chemicals are carbon tetrachloride, methyl chloroform, CFC-13, CFC-111, CFC-112, CFC-211, CFC-212, CFC-213, CFC-214, CFC-215, CFC-216, CFC-217.

Description of Proposal

The proposal would increase and apply the same base tax rate to both initially listed chemicals and newly listed chemicals. The new base tax rate would be $1.85 per pound for 1992, $2.75 per pound in 1993, $3.65 per pound in 1994, and $4.55 per pound in 1995. For years after 1995, the base tax amount would be increased by 45 cents per pound per year. Present law rates would be retained for chemicals used in rigid foam insulation.

Effective Date

The proposal would be effective for taxable chemicals sold or used on or after July 1, 1992. Appropriate floor stocks taxes would be imposed on taxed chemicals held on the effective dates of changes in the base tax rate.

10. Extension of Tax Credit for Orphan Drug Clinical Testing Expenses

Present Law

A 50-percent nonrefundable tax credit is allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases, 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 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.

Description of Proposal

The proposal would extend the orphan drug tax credit for 18 months (i.e., for qualified clinical testing expenses incurred through December 31, 1993).

Effective Date

The proposal would be effective for expenses incurred during the period July 1, 1992, through December 31, 1993.

11. UBIT Changes Relating to Real Estate Investments by Pension Funds and Others

a. Relax debt-finance restrictions

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 when such income is derived from "debt-financed property." Income from debt-financed property generally is subject to the UBIT in proportion to the amount of debt financing (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)(A)). Under this exception, income from investments in real property is not treated as income from debt-financed property. Mortgages are not considered real property for purposes of the exception.

The debt-financed exception, however, is available for investments in debt-financed property only if the following six 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, income, or profits 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 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 are satisfied by the partnership (the "partnership" restrictions) (sec. 514(c)(9)(B)(i) through (vi)).

Description of Proposal

Relax the leaseback and disqualified person restrictions

The proposal would relax the leaseback and disqualified person restrictions to permit a de minimis leaseback of debt-financed real property to the seller (or a person related to the seller) or to a disqualified person. The de minimis exception would apply only where (1) no more than 20 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.

Relax the seller-financing restriction

The proposal would relax the seller-financing restriction to permit seller financing on terms that are commercially reasonable. Regulations would be authorized for the purpose of determining commercially reasonable financing terms. In addition, seller financing that is on terms that include a down payment of at least 15% of the sales price and an interest rate of at least 150% of the applicable Federal rate ("AFR") on any indebtedness would be deemed to be commercially reasonable.

The present-law "fixed price" and "participating loan" restrictions would not be affected by this modification. Thus, for example, income from a financing arrangement (including an equity kicker) based on revenue, income, or profits generally would continue to be treated as income from debt-financed property, unless some other exception applies.

Relax the fixed price and participating loan restriction for property foreclosed on by financial institutions

The proposal also would relax the fixed price and participating loan restrictions for certain sales of real property foreclosed upon by financial institutions.[1] The relaxation of these rules would be limited to cases where: (1) a qualified organization acquires the property from a financial institution that acquired the real property by foreclosure (or after an actual or imminent default); (2) the financial institution treats any income from the sale of the property as ordinary income; (3) the stated principal amount of the seller financing does not exceed the financial institution's outstanding indebtedness (including accrued but unpaid interest) with respect to the property at the time of foreclosure; and (4) the value of the participation feature

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[1] Financial institutions include institutions in conservatorship or receivership and certain affiliates of financial institutions.

at the time of sale does not exceed 25 percent of the value of the property.

Regulations would be authorized for the purpose of clarifying these limitations. In particular, these regulations would be expected to establish standards for determining when the value of a participation feature at the time of sale does not exceed 25 percent of the value of the property. For example, a participation feature that provides the seller with less than a 25 percent interest in net proceeds, net income, or gain on sale of the property would be expected to be valued at less than 25 percent of the value of the property.

Eliminate section 514(c)(9)(B) restrictions for investments through certain large partnerships

The proposal also would eliminate the six section 514(c)(9)(B) restrictions for qualified organizations that invest in real property through certain "large" partnerships.

A "large" partnership would be a partnership having at least 250 partners that satisfies the following three tests: (1) investment units in the partnership are registered with the Securities and Exchange Commission; (2) a significant percentage (at least 50 percent) of each class of interests is owned by taxable individuals; and (3) a principal purpose of the partnership allocations is not tax avoidance. Partnership interests that are subject to the same terms would be considered to be in the same class, regardless of whether the interests are subject to different ownership restrictions (a partnership can therefore monitor the 50 percent ownership restriction by requiring that designated interests be held only by taxable persons).

Treat certain mortgages as real property

The proposal would treat mortgages as real property for purposes of section 514(c)(9), under the following conditions: (1) the mortgages have been acquired from a financial institution that is in conservatorship or receivership, (2) the mortgages have been acquired with a cash down payment of at least 50% of the sales price (i.e., the acquisition indebtedness is less than 50% of the price of the mortgages), (3) the mortgages are not debt-financed property except on account of acquisition indebtedness that is granted by the seller, and (4) the mortgages are acquired prior to January 1, 1994. Mortgages would be eligible for treatment as real property for two-and-a-half years after they are acquired by the tax-exempt purchaser.

Effective Date

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

b. Repeal UBIT rule for publicly-traded partnerships

Present Law

In general, the character of a partner's distributive share of income is the same as if the income had been directly realized by the partner. Thus, a tax-exempt organization's share of income from a partnership (other than from a publicly-traded partnership) is treated as unrelated business income, or not, depending on the underlying character of the income (sec. 512(c)(1)).

However, 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)).

Description of Proposal

The proposal would repeal the rule that automatically treats income from publicly-traded partnerships as unrelated business income. Thus, under the proposal, investments in publicly-traded partnerships would be treated the same as investments in other partnerships for purposes of the UBIT rules.

Effective Date

The proposal would be effective for partnership interests acquired on or after February 1, 1992.

c. Permit title-holding companies to receive small amounts of income that is subject to UBIT

Present Law

Code section 501(c)(2) provides tax-exempt status to certain corporations organized for the exclusive purpose of holding title to property and turning over any income from the property to one or more related tax-exempt organizations. Section 501(c)(25) provides tax-exempt status to certain corporations and trusts that are organized for the exclusive purposes of acquiring and holding title to real property,

collecting income from such property, and remitting the income therefrom to no more than 35 shareholders or beneficiaries that are: (1) qualified pension, profit-sharing, or stock bonus plans (sec. 401(a)); (2) governmental pension plans (sec. 414(d)); (3) the United States, a State or political subdivision, or governmental agencies or instrumentalities; or (4) tax-exempt charitable, educational, religious, or other organizations described in section 501(c)(3).

Ordinarily, a tax-exempt organization will not lose its exempt status because it generates unrelated business taxable income (UBTI), so long as the activities producing such taxable income are not substantial in comparison to the organization's activities that further its exempt purposes. However, the IRS has taken the position that a title-holding company described in section 501(c)(2) or 501(c)(25) will lose its tax-exempt status if it generates any amount of income subject to the UBIT.[2]

Description of Proposal

The proposal would permit a title-holding company that is exempt from tax under sections 501(c)(2) or 501(c)(25) to receive UBTI up to 10 percent of its gross income for the taxable year, provided that the UBTI is incidentally derived from the holding of real property. For example, income generated from parking or operating vending machines located on real property owned by a title-holding company generally would qualify for the 10-percent de minimis rule, while income derived from an activity that is not incidental to the holding of real property (e.g., manufacturing) would not qualify.[3]

In addition, the proposal would provide that a section 501(c)(2) or 501(c)(25) title-holding company will not lose its tax-exempt status if UBTI that is incidentally derived from the holding of real property exceeds the 10-percent limitation, provided that the title-holding company establishes to the satisfaction of the Secretary of the Treasury that the receipt of UBTI in excess of the 10-percent limitation was inadvertent and reasonable steps are being

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[2] IRS Notice 88-121, 1988-2 C.B. 457. See also Treas. Reg. sec. 1.501(c)(2)-1(a).

[3] In cases where unrelated income is incidentally derived from the holding of real property, receipt by a title-holding company of such income (up to the 10-percent limit) will not jeopardize the title-holding company's tax-exempt status, but nonetheless, will be subject to tax under the general UBIT rules.

taken to correct the circumstances giving rise to such excess UBTI.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1991.

d. Exclude from UBTI any gains from the disposition of property acquired from financial institutions in conservatorships or receiverships

Present Law

In general, gains or losses from the sale, exchange or other disposition of property are excluded from UBTI (sec. 512(b)(5)). However, gains or losses from the sale, exchange or other disposition of property held primarily for sale to customers in the ordinary course of the trade or business are not excluded from UBTI (the "dealer UBTI rule") (sec. 512(b)(5)(B)).

Description of Proposal

The proposal would create an exception to the dealer UBTI rule by excluding gains from the sale, exchange or other disposition of real property and mortgages acquired from financial institutions that are in conservatorship or receivership. The exclusion would be limited to properties designated as disposal property within six months of acquisition, and disposed of within two-and-a-half years of acquisition. The two-and-a-half year period may be extended by the Secretary if an extension is necessary for the orderly liquidation of the property. The exclusion would not be available for properties that are substantially improved or renovated after acquisition and before disposition. The exclusion generally would not be available for property that is developed except if the property is developed only in a limited manner (e.g., by securing zoning permits).

Effective Date

The proposal would be effective for property acquired after February 1, 1992.

e. Exclude loan commitment fees and certain option premiums from UBTI

Present Law

Income from a trade or business that is unrelated to an exempt organization's purpose generally is UBTI. Passive income such as dividends, interest, royalties, and gains or losses from the sale, exchange or other disposition of

property generally is excluded from UBTI (sec. 512(b)). In addition, gains on the lapse or termination of options on securities are explicitly exempted from UBTI (sec. 512(b)(5).

Present law is unclear on whether loan commitment fees and premiums from unexercised options on real estate are UBTI.

Description of Proposal

The proposal would clarify that loan commitment fees and premiums from unexercised options on real estate are excluded from UBTI.

Effective Date

The proposal would be effective for premiums or loan commitment fees that are received after February 1, 1992.

f. Exclude certain hotel rental income from UBTI

Present Law

Rents from real property generally are excluded from UBTI unless the rents are measured by reference to the net income derived by any person from the leased property (sec. 512(b)(3)). Payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, do not constitute rents from real property (Treas. Reg. sec. 1.512(b)-1(c)(5)).

Description of Proposal

The proposal would exclude from UBTI any hotel rental income when (i) the hotel has been acquired from a financial institution in receivership or conservatorship, (ii) the hotel has been designated as disposal property within six months of acquisition, and (iii) the hotel either is disposed within two-and-a-half years of acquisition or, after two-and-a-half years, any related services are rendered by an independent contractor pursuant to a contract that does not permit the exempt organization to share any of the net income of the independent contractor.

Effective Date

The proposal would be effective for hotels acquired after February 1, 1992.

12. Tax Credit for First-Time Homebuyers

Present Law

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

Description of Proposal

Under the proposal, individuals who purchase a new principal residence would be eligible to receive a tax credit equal to 10 percent of the purchase price of the residence, up to a maximum credit of $5,000. The credit would apply to a new principal residence if the original use of the residence commences with the taxpayer and if the taxpayer (1) acquires such residence on or after February 1, 1992, and before January 1, 1994, or (2) enters into a binding contract to acquire the residence on or after February 1, 1992, and before January 1, 1994, and purchases the residence within 90 days of entering into that binding contract. Only one tax credit could be claimed per residence.

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

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

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

Effective Date

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

13. Passive Loss Relief for Real Estate Developers

Present Law

The passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. Deductions that are suspended under this rule are carried forward and treated as deductions from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person.

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

Rental activities are also included in the definition of passive activities (regardless of the level of the taxpayer's participation). In general, rental activities are treated as separate from other business activities. A special rule permits the deduction of up to $25,000 of losses from certain rental real estate activities (even though they are considered passive), if the taxpayer actively participates in them. This $25,000 amount is allowed for taxpayers with adjusted gross incomes of $100,000 or less, and is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000. In general, 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. The active participation standard requires an ownership interest of no less than 10 percent in the rental real estate. A taxpayer generally is deemed not to satisfy the active participation standard (or the material participation standard) with respect to property he holds through a limited partnership interest.

Description of Proposal

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. Income and loss for the taxable year from Qualified Property would not be treated as passive, but net losses from Qualified Property would be allowed only to the extent of net income

from Qualified Property and 80 percent of the taxpayer's taxable income for the year that is attributable to real estate development activities other than the rental of Qualified Property. Losses from Qualified Property that exceed this amount for the year are carried forward and treated as losses from Qualified Property in the next year. Losses arising from Qualified Property in a prior year that were suspended and carried forward as passive activity losses would be subject to the same limitation as losses from Qualified Property. Credits from Qualified Property would be treated similarly.

In order to be Qualified Property, rental real property must meet the following criteria: (1) the taxpayer owns a non-de minimis interest in the rental real property; and (2) the taxpayer actively participates in the rental real property during the current taxable year.

A taxpayer's real estate development activity would be considered a single trade or business activity which includes 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 non-de minimis ownership interest, and (3) the rental of Qualified Property. Material participation and active participation would generally have the same meaning as under present law; however, active participation would not require a 10-percent ownership interest.

The proposal would apply only to property placed in service before the date of Committee action. Property that is substantially improved after that date would be treated as placed in service after that date.

Effective Date

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

14. Increase Recovery Period for Depreciation of Nonresidential Real Property

Present Law

A taxpayer is allowed to recover, through annual depreciation allowances, the cost or other basis of nonresidential real property that is used in a trade or business or that is held for the production of rental income. For regular tax purposes, the amount of the depreciation deduction allowed with respect to nonresidential real property for any taxable year generally is determined using the straight-line method and a recovery period of 31.5 years. For alternative minimum tax purposes, the amount of the depreciation deduction allowed with respect to nonresidential real property for any taxable year is determined using the straight-line method and a recovery period of 40 years.

Description of Proposal

The depreciation deduction allowed with respect to nonresidential real property for any taxable year would be determined by using the straight-line method and a recovery period of 40 years for purposes of the regular tax and the alternative minimum tax.

Effective Date

The proposal generally would apply to property placed in service after February 12, 1992. The proposal would not apply to property that is placed in service by a taxpayer before January 1, 1995, if (1) the taxpayer or a qualified person entered into a binding written contract to purchase or construct the property before February 13, 1992, or (2) construction of the property was commenced by or for the taxpayer or a qualified person before February 13, 1992. For this purpose, a qualified person would be defined as any person who transfers his or her rights in such a contract or in the property to the taxpayer, but only if the property is not placed in service by such person before such rights are transferred to the taxpayer.

15. Extension of Low-Income Housing Tax Credit

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 portion of the building for which the credit is claimed must be rented to qualified low-income tenants at restricted rents for 15 years after the building is placed in service. In addition, a subsequent additional 15-year period of low-income use is required.

Each State receives an annual low-income housing credit volume limitation 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.

Description of Proposal

The low-income housing credit would be extended for 18 months, through December 31, 1993.

The proposal also would make several modifications to the credit:

(1) For purposes of the carryforward rules, credits carried forward from previous years would be treated as used before current year credits. Under present law, current year credits are deemed to be used before credits which have been carried forward.

(2) A waiver from the credit's ten-year anti-churning rule would be provided for certain projects substantially assisted, financed, or operated under sec 221(d)(4) of the National Housing Act. Absent such waiver these properties are not eligible for the credit if they were placed in service within the previous ten years.

(3) The eligible basis of each unit of a credit project would be limited to an amount equal to the maximum FHA single

family insurance amount (currently $124,875). This amount would be indexed for inflation.

(4) Clarification would be provided that a unit occupied entirely by full-time students may qualify for the credit if the full-time students are a parent and his or her minor children and the tenants are not dependents of a third party.

(5) The Treasury Department would be authorized to grant a waiver of penalties for de minimis errors in the application of the low-income tenant set-aside rules.

(6) The Treasury Department would be authorized to grant a waiver from the annual recertification of tenant income, for tenants in a building, if the population of a building is composed entirely of low-income tenants.

(7) The bill would provide that community service buildings in projects in qualified census tracts are included in eligible basis as functionally related and subordinate facilities if (a) the size of the facilities is commensurate with tenant needs, and (b) the use of the facilities is predominantly (although not exclusively) by tenants and employees of the project owner, and (c) no more than 20 percent of the credit project's eligible basis is attributable to the aggregate basis of such facilities.

Effective Date

The proposal would be effective on the date of enactment.

The modifications to the low-income housing tax credit program rules generally would be effective for allocations of low-income credit volume limitation (and bond-financed buildings financed with tax-exempt bonds issued after) June 30, 1992. The change to the credit carryforward rules would be effective on and after January 1, 1992.

16. Extension of Qualified Mortgage Bond and Mortgage Credit Certificate Programs

Present Law

Qualified mortgage bonds

Qualified mortgage bonds ("QMBs") are tax-exempt 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 either disposes of the residence acquired with the QMB loan or no longer uses the residence as his or her principal residence, within nine years after its purchase.

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.

Description of Proposal

Authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs would be extended for 18 months, through December 31, 1993.

Effective Date

The proposal would apply to bonds issued after June 30, 1992.

17. Special Depreciation Allowance for Certain Equipment Acquired in 1992

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 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"), most tangible personal property is depreciated using the 150-percent declining balance method over useful lives that typically are 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 (but not below zero) 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).

Description of Proposal

The proposal would allow an additional first-year depreciation deduction equal to 10 percent of the adjusted

basis of certain qualified property that is placed in service before July 1, 1993. The additional depreciation deduction would be allowed for both regular tax and AMT purposes for the taxable year in which the property is placed in service. The basis of the property and the depreciation allowances in the year of purchase and later years would be appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer would be allowed to elect not to claim the additional first-year depreciation for qualified property.

Property would qualify 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 on or after February 1, 1992. In addition, the property must be acquired by the taxpayer (1) on or after February 1, 1992, and before January 1, 1993, but only if no binding written contract for the acquisition is in effect before February 1, 1992, or (2) pursuant to a binding written 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 would qualify if the taxpayer begins the manufacture, 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 (sec. 280F of the Code) would be adjusted to reflect the additional first year depreciation deduction.

The following examples illustrate the operation of the proposal.

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 proposal, the taxpayer would be allowed an additional first-year depreciation deduction of $100,000. The remaining $900,000 of adjusted basis would 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. Under the proposal, the taxpayer first would be allowed a $10,000 deduction under section 179. The taxpayer would then be allowed an additional first-year depreciation deduction of $2,000 based on $20,000 ($30,000 original cost less the section 179 deduction of $10,000) of adjusted basis.

Finally, the remaining adjusted basis of $18,000 ($20,000 adjusted basis less $2,000 additional first-year depreciation) would be recovered in 1992 and subsequent years pursuant to the depreciation rules of present law.

Effective Date

The proposal would apply to property placed in service on or after February 1, 1992.

18. Extension of Relief for AMT Purposes for Contributions of Appreciated Property

Present Law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair-market value of property contributed to a charitable organization.[1] However, in the case of a charitable contribution of inventory or other ordinary-income property, short-term capital gain property, or certain gifts to private foundations, the amount of the deduction generally is limited to the taxpayer's adjusted basis in the property. In the case of a charitable contribution of tangible personal property, a taxpayer's deduction 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 (sec. 57(a)(6)). 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.

Description of Proposal

AMT treatment of donated appreciated property

The proposal provides that all charitable contributions of appreciated property (real, personal, or intangible property) made during 1992 and 1993 would not be treated as a tax preference item for alternative minimum tax (AMT) purposes.

Advance determination of IRS position of value of donated tangible personal property

The Secretary of the Treasury would be directed to develop and implement a procedure under which the Secretary's position as to the value of tangible personal property could be ascertained for Federal income tax purposes prior to the

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[1] 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)).

transfer of such property to a charitable organization. The Secretary would be required to submit a report not later than December 31, 1992, to the Senate Committee on Finance and the House Committee on Ways and Means, reporting on the development of such a procedure and the projected timetable for its implementation.

Study of tax treatment of corporate sponsorship payments to charitable organizations

The Treasury Department would be directed to conduct a study on the tax treatment of corporate sponsorship payments received by charitable and other tax-exempt organizations in connection with athletic (and other) events and the ramifications of IRS proposed examination guidelines contained in Announcement 92-15, 1992-5 I.R.B. 51. Within one year after the date of enactment, the Treasury Department would be required to report the results of this study to the Senate Committee on Finance and the House Committee on Ways and Means.

Effective Date

The proposal governing the AMT treatment of gifts of appreciated property would be effective for contributions made in 1992 and 1993.

The Secretary of Treasury would be required to report to Congress prior to December 31, 1992, on the development of an advance valuation procedure for certain donations, and within one year after the date of enactment, the results of a study of corporate sponsorship payments received by tax-exempt organizations.

19. Alternative Minimum Tax Relief for Intangible Drilling Costs of Oil and Gas Independent Producers

Present Law

Independent oil and gas producers who pay or incur intangible drilling or development costs ("IDCs") in the development of domestic oil or gas properties or certain geothermal wells, may elect either to expense or capitalize such amounts. If an election to expense IDCs is made, the taxpayer deducts the amount of the IDCs as an expense in the taxable year the cost is paid or incurred. Generally, if IDCs are not expensed, but are capitalized, they can be recovered through depletion or depreciation, as appropriate; or at the election of the taxpayer, they may be amortized over a 60-month period.

The difference between the amount of a taxpayer's IDC deductions and the amount which would have been currently deductible had IDCs been capitalized and recovered over a 10-year period constitute an item of tax preference for the alternative minimum tax (AMT) to the extent that this difference exceeds 65 percent of the taxpayer's net income from oil, gas, and geothermal properties for the taxable year. Moreover, for purposes of computing the "adjusted current earnings" (ACE) adjustment of the corporate AMT, IDCs are capitalized and amortized over the 60-month period beginning with the month in which they are paid or incurred.

A portion of the IDC tax preference and IDC-related ACE adjustment (together with a portion of preference and ACE adjustment related to percentage depletion from marginal properties) may operate to reduce an independent oil and gas producer's alternative minimum taxable income under a provision enacted as part of the Omnibus Budget Reconciliation Act of 1990 (the so-called "special energy deduction"). The special energy deduction is initially determined by determining the taxpayer's (1) IDC preference[1] and (2) marginal production depletion preference.[2] The IDC preference is apportioned between the portion of the preference related to exploratory drilling costs and the

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[1] The IDC preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to the excess IDC preference and the ACE IDC adjustment.

[2] The marginal production depletion preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to the excess depletion preference and the ACE depletion adjustment related to marginal property.

portion related to all other drilling costs. The portion of the preference related to exploratory IDCs is multiplied by 75 percent and the remaining portion is multiplied by 15 percent. The marginal production depletion preference is multiplied by 50 percent. These three products are then added together to arrive at the taxpayer's special energy deduction. The special energy deduction, however, may not reduce the taxpayer's alternative minimum taxable income by more than 40 percent.

Description of Proposal

For purposes of computing the AMT preference for IDCs of an independent oil and gas producer, the proposal would raise the 65-percent net oil and gas income offset to 80 percent. Thus, the difference between the amount of a taxpayer's IDC deductions and the amount which would have been currently deductible had IDCs been capitalized and recovered over a 10-year period would constitute an item of tax preference for an independent producer to the extent that this difference exceeds 80 percent of the taxpayer's net income from oil, gas, and geothermal properties for the taxable year.

In addition, for purposes of computing adjusted current earnings, the proposal would eliminate the requirement that independent oil and gas producers make an adjustment to alternative minimum taxable income for IDCs.

The proposal also would alter the special energy deduction. Under the proposal, the IDC component of the special energy deduction would be computed by multiplying the IDC preference by 50 percent. Thus, the proposal would eliminate any necessity to apportion the IDC preference between exploratory and all other IDCs. As under present law, the special energy deduction would be allowed to reduce a taxpayer's alternative minimum taxable income by no more than 40 percent.

Effective date

The proposal would be effective for taxable years beginning after December 31, 1991.

20. Elimination of ACE Depreciation Adjustment

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.

Description of Proposal

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

Effective Date

The proposal would be effective for property placed in service on or after February 1, 1992.

21. Research and Experimentation Tax Credit

Present Law

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

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

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

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

In addition, the 20-percent tax credit also applies to the 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.

Description of Proposal

The research tax credit would be extended for 18 months (i.e., for qualified research expenditures and university basic research expenditures incurred through December 31, 1993).

Effective Date

The proposal would apply to qualified expenditures incurred during the period July 1, 1992, through December 31, 1993.

22. Progressive Capital Gains Tax Rates

Present Law

Under present law, ordinary income of an individual is taxed at a maximum marginal rate of 31 percent. 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.

Description of Proposal

An individual's net capital gain from the sale or exchange of qualified capital assets held more than two years ("qualified capital gain") would be taxed pursuant to a new progressive rate system.

A capital gains tax rate of 5, 19, 23, or 28 percent would apply depending on the individual's taxable income. The applicable capital gains tax rate would be determined by first taking into account taxable income computed without regard to the qualified capital gain. The qualified capital gain then would be added to such amount. The portion of qualified capital gain otherwise taxed at a 15-percent rate would be taxed at a rate of 5 percent; the portion otherwise taxed at a 28-percent rate would be taxed at a rate of 19 percent; the portion otherwise taxed at a 31-percent rate would be taxed at a rate of 23 percent; and the portion otherwise taxed at the 36-percent rate (as added by the proposal) would be taxed at a rate of 28 percent.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded.

The entire amount of qualified capital gain would be included in alternative minimum taxable income.

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, subject to a maximum marginal rate of 31 percent.

Effective Date

The proposal 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, the new capital gains rates would apply for qualified capital assets held more than one year. For 1993 and thereafter, the

proposal would be fully phased in, and the new rates would apply for qualified capital assets held more than two years.

23. Exclusion for Capital Gains on Certain Small Business Stock

Present Law

Under present law, ordinary income of an individual is taxed at a maximum marginal rate of 31 percent. 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. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income, i.e., 34 percent.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Description of Proposal

Taxpayers would be entitled to exclude 50 percent of the gain realized on the sale or exchange of certain small business stock held for more than five years.[1]

In order to qualify as small business stock, the following requirements must be met: (1) the stock must be in a domestic corporation (other than a corporation engaged in certain disqualified activities);[2] (2) the corporation must satisfy an active business test (certain start-up activities would qualify); (3) the excess of (i) the amount of cash and

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[1] A corporation would not be entitled to the exclusion if it owns more than 50 percent of the vote or value of the corporation issuing the small business stock.

[2] An eligible corporation would not include a corporation predominantly engaged in a disqualified business (i.e., farming business, any business of operating a hotel, motel, restaurant or similar property, or any banking, insurance, financing or similar business). An eligible corporation also would not include a corporation with more than 10 percent of its assets in portfolio stock investments or real property not used in an active business (owning, renting or dealing in real property would not be active), a corporation the principal activity of which is the performance of personal services, a DISC, a 936 company, a RIC, REIT or REMIC, or any cooperative.

the aggregate adjusted bases of the corporation's assets, over (ii) the corporation's short-term debt, must not exceed $100 million;[3] and (4) the stock must be originally issued on or after February 1, 1992 to the taxpayer in exchange for money or other property (not including stock) or as compensation for services.[4]

In the case of stock acquired through the exercise of an option or through the conversion of convertible debt, the determination whether the $100 million assets test is met would be made at the time of exercise or conversion. In addition, the holding period of such stock would be treated as beginning on the date of exercise or conversion.

In the case of convertible preferred stock, the assets test would be made at the time the convertible stock is issued, and the holding period of the convertible stock would be added to that of the stock acquired upon conversion.

Stock received in connection with the performance of services would be treated as issued when included in the taxpayer's gross income.

The exclusion would be a preference for purposes of the alternative minimum tax.

Any gain from the sale or exchange of small business stock that is eligible for the exclusion would not also be eligible for the new progressive capital gains rate system (as added by the proposal).

Effective Date

The proposal would apply to stock issued on or after February 1, 1992.

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[3] If a corporation exceeds this limit at any time on or after February 1, 1992, the corporation could never issue stock that would qualify for the exclusion. A corporation that exceeds this limit could not split itself into smaller companies in an attempt to qualify new stock issued by such companies for the exclusion. If a corporation acquires substantially all the assets of a trade or business from another corporation whose assets exceed $100 million, stock in the acquiring corporation also would not qualify for the exclusion.

[4] In order to prevent evasion of the requirement that the stock be newly issued, the exclusion would not apply if the issuing corporation purchases any of its stock either one year before or one year after the new issuance, unless the corporation has a business purpose for the redemption.

24. Extension of Qualified Small-Issue Bonds

Present Law

Interest on certain small issues of private activity bonds ("qualified small-issue bonds") is excluded from gross income if certain conditions are met. First, at least 95 percent of the bond proceeds must be used to finance manufacturing facilities or certain agricultural land or equipment. Second, the bond issues must have an aggregate face amount of $1 million or less, or 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.

Authority to issue qualified small-issue bonds is scheduled to expire after June 30, 1992.

Description of Proposal

Authority to issue qualified small-issue bonds would be extended for 18 months, through December 31, 1993.

Effective Date

The proposal would be effective for bonds issued after June 30, 1992.

25. Business Energy Tax Credits for Solar and Geothermal Property

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.[1]

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.

Description of Proposal

The proposal would extend the business credits for solar and geothermal property for 18 months, through December 31, 1993.

Effective Date

The proposal would be effective for qualifying solar and geothermal property placed in service after June 30, 1992.

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[1] 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)).

26. Classification of Multi-Purpose Vehicles

Present Law

Under present regulations, multi-purpose vehicles (MPVs) such as mini-vans and sport utility vehicles are inconsistently classified as autos or trucks. For purposes of emission and fuel economy standards, most MPVs are classified as trucks. However, for customs purposes, MPVs with more than two doors are generally classified under the Harmonized Tariff System (HTS) as vehicles "principally designed for the transport of persons" (HTS heading 8703), subject to a 2.5 percent duty. Two-door MPVs are generally classified as vehicles "principally designed for the transport of goods" (HTS heading 8704), subject to a 25 percent duty. The current tariff classification resulted from a controversial Treasury Department ruling in 1989 reversing an earlier Customs Service ruling which classified all MPVs under HTS heading 8704 and subjected them to the 25 percent duty.

Description of Proposal

The amendment would incorporate into the HTS language from the regulations of the Environmental Protection Agency and the Department of Transportation such that MPVs classified as trucks for emission and fuel economy standards would also be classified as trucks for tariff purposes. The effect would be to raise the duty on certain MPVs from 2.5 percent to 25 percent.

Effective Date

The proposal would be effective 15 days after the bill's enactment.

27. Limit Deduction for Executive Compensation

Present Law

Under present law, a deduction is allowed in computing Federal income tax liability for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Description of Proposal

For purposes of the regular income tax and the alternative minimum tax, the otherwise allowable deduction for compensation paid or accrued with respect to a covered employee would be limited to no more than $1 million per year. A covered employee means any employee of the taxpayer who is an officer of the taxpayer, other than an employee-owner of a personal service corporation.

The term covered employee would include former employees. Thus, for example, the proposal would apply to compensation paid to former employees (e.g., nonqualified deferred compensation that is not paid until after termination of employment) as well as current employees.

The proposal would not apply to compensation paid to employees who are not officers. Similarly, the proposal would not apply to payments to partners in a partnership because they are not employees. The proposal also would not apply to payments to independent contractors.

The deduction limitation generally would apply to all remuneration for services, including the cash value of all remuneration (including benefits) paid in a medium other than cash. The limit would not apply to fringe benefits excludable from income under section 132, meals and lodging furnished on the business premises of the employer that are excludable under section 119, or contributions to qualified pension and annuity plans or tax-sheltered annuities.

Effective Date

The proposal would be effective for taxable years beginning on or after January 1, 1992.

28. Employer-Provided Transportation Benefits

Present Law

Under Treasury regulations, monthly transit passes, tokens, etc., provided by an employer are excludable from an employee's income and wages for income and employment tax purposes as a de minimis fringe benefit if the total value of the transit pass does not exceed $21. If the total value of such benefits exceeds $21 per month, the full value of the benefits is includible in income.

Parking at or near the employer's business premises that is paid for by the employer is excludable from the gross income of the employee as a working condition fringe benefit, regardless of the value of the parking.

Description of Proposal

Under the proposal, gross income would not include qualified transportation fringe benefits. In general, a qualified transportation fringe would be (1) transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment, (2) a transit pass, or (3) qualified parking. The maximum amount of qualified parking that could be excluded from an employee's gross income would be $160 per month (regardless of the total value of the parking). Other qualified transportation fringes would be excludable from gross income to the extent that the aggregate value of the benefits does not exceed $60 per month. Both dollar limits would be indexed for inflation.

A transit pass would include any pass, token, farecard, voucher, or similar item entitling a person to transportation on mass transit facilities (whether or not publicly owned). Types of transit facilities that could qualify for the exclusion include, for example, rail, bus, and ferry.

Qualified parking would be parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work by mass transit, in a commuter highway vehicle, or by carpool.

Effective Date

The proposal would apply to benefits provided by the employer on or after January 1, 1992, except that the $160 per month limit on the exclusion for qualified parking benefits would apply to benefits provided after the date of enactment.

29. Repeal of Luxury Excise Tax on Boats, Aircraft, Jewelry, and Furs; Modification of Luxury Excise Tax on Vehicles

Present Law

Present law imposes ten-percent excise taxes on the portion of the retail price of the following items that exceeds the thresholds specified: automobiles above $30,000; boats above $100,000; aircraft above $250,000; jewelry above $10,000; and furs above $10,000.

The tax generally applies only to the first retail sale after manufacture, production or importation of items subject to the tax. It does not apply to subsequent sales of these items. The taxes on automobiles, boats, and aircraft generally do apply to items used in a trade or business.

The tax applies to sales before January 1, 2000.

Description of Proposal

The proposal would repeal the excise taxes imposed on boats, airplanes, jewelry, and furs.

The proposal also would modify the tax on automobiles to provide that the $30,000 threshold is indexed for inflation occurring after 1990.

Effective Date

The repeal of the taxes on boats, aircraft, jewelry, and furs would be effective for sales on or after January 1, 1992. The indexation of the threshold applicable to automobiles would be effective for sales on or after January 1, 1992.

30. Impose Excise Tax on Diesel Fuel Used in Noncommercial Motorboats

Present Law

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

The revenues from these taxes, minus 2.5 cents per gallon, are deposited in the Highway Trust Fund ("HTF"), the National Recreational Trails Trust Fund, or the Aquatic Resources Trust Fund through September 30, 1999. Revenues from the remaining 2.5 cents per gallon are retained in the General Fund through September 30, 1995, after which time the 2.5-cents-per-gallon portion of the taxes (including the tax on diesel fuel used in trains) is scheduled to expire.

An additional 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.

Diesel fuel used in motorboats is not taxed.

Description of Proposal

The provision would extend the current 20.1-cents-per-gallon diesel fuel excise taxes to diesel fuel used by recreational motorboats. Fuel used by motorboats for commercial fishing, transportation for compensation or hire, or for business use other than predominantly for entertainment, amusement, or recreation, would remain exempt.

As under the President's budget proposal, the tax is collected at the same point in the distribution chain as the highway diesel fuel tax (i.e., on sale to a retailer). However, to prevent unnecessary tax-paid sales followed by refunds, retailers that sell diesel fuel exclusively to commercial (i.e., nonpleasure) boats are permitted to buy the fuel tax-free.

The revenues from the entire 20.1-cents-per-gallon tax on diesel fuel used by motorboats would be retained in the General Fund.

Effective Date

The provision would be effective after June 30, 1992.

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

Present Law

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

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

The DVA disclosure provision is scheduled to expire after September 30, 1992.

Description of Proposal

The proposal would extend this authority to disclose tax information for six years.

Effective Date

The DVA disclosure provision would expire after September 30, 1998.

32. Extension of Excise Tax on Certain Vaccines for the Vaccine Injury Compensation Trust Fund

Present Law

The Vaccine Injury Compensation Trust Fund ("Vaccine Trust Fund") provides a source of revenue to compensate individuals who are injured (or die) as a result of the administration of certain vaccines: diphtheria, pertussis, and tetanus ("DPT"); diphtheria and tetanus ("DT"); measles, mumps, and rubella ("MMR"); and polio. The Vaccine Trust Fund provides the funding source for the National Vaccine Injury Compensation Program ("Program"), which provides a substitute, Federal "no-fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers.

The Vaccine Trust Fund is funded by a manufacturer's excise tax on DPT, DT, MMR, and polio vaccines (and any other vaccines used to prevent these diseases). The excise tax per dose is $4.56 for DPT, $0.06 for DT, $4.44 for MMR, and $0.29 for polio vaccines.

The vaccine excise tax will expire after the later of: (1) December 31, 1992; or (2) the date on which the Vaccine Trust Fund revenues exceed the projected liabilities with respect to compensable injuries from vaccines administered before October 1, 1992. Amounts in the Vaccine Trust Fund are available for the payment of compensation under the Program with respect to vaccines administered after September 30, 1988, and before October 1, 1992.

Description of Proposal

The present-law excise taxes imposed on certain vaccines and the Vaccine Trust Fund would be extended for two years (through December 31, 1994, and October 1, 1994, respectively).

The Treasury and Health and Human Services Departments would be required to study and report to the Committees on Finance and Ways and Means by January 1, 1994, certain issues regarding Vaccine Trust Fund funding needs and appropriateness of imposition and rate of tax on covered vaccines.

Effective Date

The provisions would be effective on the date of enactment.

33. Permanent Extension of General Fund Transfer to Railroad Retirement Tier 2 Fund

Present Law

The proceeds from the income taxation of railroad retirement Tier 2 benefits are transferred from the general fund of the Treasury to the Railroad Retirement Account. This transfer applies only to proceeds from the taxation of benefits which have been received prior to October 1, 1992. Proceeds from the taxation of benefits received after this date remain in the general fund.

Description of Proposal

The transfer of proceeds from the income taxation of railroad retirement Tier 2 benefits from the general fund of the Treasury to the Railroad Retirement Account would be made permanent.

Effective Date

The provision would be effective beginning September 30, 1992.

34. Allocation and Apportionment of Research Expenses

Present Law

U.S. persons are taxable on their worldwide income, including their foreign income. Foreign source taxable income equals foreign source gross income less the expenses, losses and other deductions properly apportioned or allocated to that income. The Internal Revenue Code generally articulates only the broad principles of how expenses reduce U.S. and foreign source gross income, leaving the Treasury Department to provide detailed rules for the task of allocating and apportioning expenses.

Treasury regulations issued in 1977 described methods for allocating expenses between U.S. and foreign source income, including rules for the allocation of research and development (R&D) expenses. Upon issuance of these regulations, a significant dispute regarding the appropriate allocation of R&D expenses developed between taxpayers and the Treasury Department. This unresolved dispute between taxpayers and the Treasury Department precipitated Congressional involvement on this issue, and since 1981, the R&D allocation regulations have been subject to a series of eight suspensions and temporary modifications. The current temporary provision is applicable generally for the first six months of the first taxable year beginning after August 1, 1991, and among other rules, automatically allocates 64 percent of U.S. performed R&D to U.S. source income, and generally permits a greater amount of taxable income to be classified as foreign source than under the 1977 regulations. This will increase the benefits of the foreign tax credit to many taxpayers.

Description of Proposal

The report of the Senate Finance Committee on the bill would contain language indicating that it believes that the Administration has broad authority under current law to revise the current R&D allocation regulations. The report would state that since the Administration has indicated its support of an allocation system that provides incentives to increase the performance of U.S.-based research activities, the committee expects, and in the strongest terms, urges the Treasury Department to revise its permanent regulations in a manner consistent with the Administration's stated objectives and proposals. The report would state that the committee believes that such a revision would be consistent both with current law regulatory authority and with the stated goals of the Administration.

The report would state that the committee further urges the Treasury Department, when revising its regulations, to take into consideration that taxpayers, in appropriate

circumstances, are required for business purposes to conduct significant amounts of R&D at foreign sites and should not be penalized by the allocation rules.

Effective Date

The report would state that the committee expects and requests the Treasury Department to issue regulations no later than June 1, 1992, to be effective after the termination of the current temporary rules.

C. Provisions to Ensure High-Income Taxpayers Pay Their Fair Share

1. Individual Income Tax Rates (36-Percent Bracket)

Present Law

For 1992, the individual income tax rate schedules are as follows--

If taxable income is	Then income tax equals
Single individuals	
$0-$21,450	15 percent of taxable income.
$21,450-$51,900	$3,217.50 plus 28% of the amount over $21,450.
Over $51,900	$11,743.50 plus 31% of the amount over $51,900.
Heads of households	
$0-$28,750	15 percent of taxable income.
$28,750-$74,150	$4,312.50 plus 28% of the amount over $28,750.
Over $74,150	$17,024.50 plus 31% of the amount over $74,150.
Married individuals filing joint returns	
$0-$35,800	15 percent of taxable income.
$35,800-$86,500	$5,370 plus 28% of the amount over $35,800.
Over $86,500	$19,566 plus 31% of the amount over $86,500.
Married individuals filing separate returns	
$0-17,900	15 percent of taxable income.
$17,900-$43,250	$2,685 plus 28% of the amount over $17,900.
Over $43,250	$9,783 plus 31% of the amount over $43,250.

Estates and trusts

$0-3,600	15 percent of taxable income.
$3,600-$10,900	$540 plus 28% of the amount over $3,600.
Over $10,900	$2,584 plus 31% of the amount over $10,900.

Description of Proposal

The proposal would create a 36-percent bracket for taxable incomes above: $150,000 (unmarried individuals filing single returns); $162,500 (unmarried individuals filing as heads of households); $175,000 (married individuals filing joint returns); $87,500 (married individuals filing separate returns); and $3,500 (estates and trusts). The thresholds for the 36-percent bracket would be adjusted for inflation in the same manner as under present law. The individual income tax rate schedules for 1992 would be as follows--

If taxable income is	Then income tax equals
Single individuals	
$0-$21,450	15 percent of taxable income.
$21,450-$51,900	$3,217.50 plus 28% of the amount over $21,450.
$51,900-$150,000	$11,743.50 plus 31% of the amount over $51,900.
Over $150,000	$42,154.50 plus 36% of the amount over $150,000.
Heads of households	
$0-$28,750	15 percent of taxable income.
$28,750-$74,150	$4,312.50 plus 28% of the amount over $28,750.
$74,150-$162,500	$17,024.50 plus 31% of the amount over $74,150.
Over $162,500	$44,413 plus 36% of the amount over $162,500.
Married individuals filing joint returns	
$0-$35,800	15 percent of taxable income.
$35,800-$86,500	$5,370 plus 28% of the amount over $35,800.

$86,500-$175,000	$19,566 plus 31% of the amount over $86,500.
Over $175,000	$47,001 plus 36% of the amount over $175,000.

Married individuals filing individuals separate returns

$0-$17,900	15 percent of taxable income.
$17,900-$43,250	$2,685 plus 28% of the amount over $17,900.
$43,250-$87,500	$9,783 plus 31% of the amount over $43,250.
Over $87,500	$23,500.50 plus 36% of the amount over $87,500.

Estates and trusts

$0-3,500	15 percent of taxable income.
Over $3,500	$525 plus 36% of the amount over $3,500.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1991.

2. Surtax on Taxable Income in Excess of $1 Million

Present Law

Under present law, there is no surtax imposed on higher-income individuals.

Description of Proposal

The proposal would impose a 10-percent surtax on individuals with taxable income over $1,000,000 ($500,000 for married taxpayers filing separate returns). The surtax would equal 10 percent of otherwise computed tax liability multiplied by the ratio of taxable income in excess of $1,000,000 to total taxable income. The effect of the proposal would be that the more that taxable income exceeds $1,000,000, the closer the surtax approaches a 10-percent increase in total tax liability.

A 2.4-percentage point surtax would apply to individuals with alternative minimum taxable income above $1,000,000 ($500,000 for married taxpayers filing separate returns). The surtax would be applied by increasing the taxpayer's tentative minimum tax by 2.4 percent of the amount by which the taxpayer's alternative minimum taxable income exceeds $1,000,000 ($500,000 for married taxpayers filing separate returns).

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1991.

3. Extension of Itemized Deduction Limitation

Present Law

Under present law, individuals who do not elect the standard deduction may claim itemized deductions (subject to certain limitations) for certain nonbusiness expenses incurred during the taxable year. Among these deductible expenses are unreimbursed medical expenses, casualty and theft losses, charitable contributions, qualified residence interest, State and local income and property taxes, unreimbursed employee business expenses, and certain other miscellaneous expenses.

Certain itemized deductions are allowed only to the extent that the amount exceeds a specified percentage of the taxpayer's adjusted gross income (AGI). Unreimbursed medical expenses for care of the taxpayer and the taxpayer's spouse and dependents are deductible only to the extent that the total of these expenses exceeds 7.5 percent of the taxpayer's AGI. Nonbusiness casualty or theft losses are deductible only to the extent that the amount of loss arising from each casualty or theft exceeds $100 and only to the extent that the net amount of casualty and theft losses exceeds 10 percent of the taxpayer's AGI. Unreimbursed employee business expenses and certain other miscellaneous expenses are deductible only to the extent that the total of these expenses exceeds 2 percent of the taxpayer's AGI.

The total amount of otherwise allowable itemized deductions (other than medical expenses, casualty and theft losses, and investment interest) is reduced by 3 percent of the amount of the taxpayer's AGI in excess of $105,250 in 1992 (indexed for inflation). Under this provision, otherwise allowable itemized deductions may not be reduced by more than 80 percent. In computing the reduction of total itemized deductions, all present-law limitations applicable to such deductions are first applied and then the otherwise allowable total amount of deductions is reduced in accordance with this provision.

The reduction of otherwise allowable itemized deductions does not apply to taxable years beginning after December 31, 1995.

Description of Proposal

The proposal would extend permanently the present-law itemized deduction limitation applicable to higher-income individuals.

Effective Date

The proposal would be effective for taxable years beginning in 1996 and thereafter.

4. Extension of Personal Exemption Phaseout

Present Law

Present law permits a personal exemption deduction from gross income for an individual, the individual's spouse, and each dependent. For 1992, the amount of this deduction is $2,300 for each exemption claimed. This exemption amount is adjusted for inflation. The deduction for personal exemptions is phased out for taxpayers with adjusted gross income (AGI) above a threshold amount (indexed for inflation) which is based on filing status. For 1992, the threshold amounts are $157,900 for married taxpayers filing joint returns, $78,950 for married taxpayers filing separate returns, $131,550 for unmarried taxpayers filing as head of household, and $105,250 for unmarried taxpayers filing as single.

The total amount of exemptions which may be claimed by a taxpayer is reduced by 2 percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold (the phaseout rate is 4 percent for married taxpayers filing separate returns). Thus, the personal exemptions claimed are phased out over a $122,500 range, beginning at the applicable threshold.

This provision does not apply to taxable years beginning after December 31, 1995.

Description of Proposal

The proposal would extend permanently the present-law personal exemption phaseout.

Effective Date

The proposal would be effective for taxable years beginning in 1996 and thereafter.

5. Conform Book and Tax Accounting for Securities Inventories

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.

Description of Proposal

Under the proposal, taxpayers who hold securities as inventory would be required to include such securities in inventory at market value for Federal income tax purposes.

Effective Date

The proposal would apply to taxable years ending on or after December 31, 1993. Any increase in inventory required by this change in method of accounting would be included in gross income ratably over 10 taxable years.

6. Modify Estimated Tax Payment Rules for Large Corporations

Present Law

A corporation is subject to an addition to tax for any underpayment of estimated tax. For taxable years beginning in 1993, 1994, 1995, and 1996, a corporation does not have an underpayment of estimated tax if it makes four equal timely estimated tax payments that total at least 95 percent of the tax liability shown on the return for the current taxable year. In addition, a corporation may annualize its taxable income and make estimated tax payments based on 95 percent of the tax liability attributable to such annualized income.

For taxable years beginning in 1992, the 95 percent requirement is a 93 percent requirement; the 95 percent requirement becomes a 90 percent requirement for taxable years beginning in 1997 and thereafter.

A corporation that is not a "large corporation" generally may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25 percent of its tax liability for the preceding taxable year (the "100 percent of last year's liability safe harbor"). A large corporation may use this rule with respect to its estimated tax payment for the first quarter of its current taxable year. A large corporation is one that had taxable income of $1 million or more for any of the three preceding taxable years.

Description of Proposal

For taxable years beginning after 1996, a corporation that does not use the 100 percent of last year's liability safe harbor for its estimated tax payments would be required to base its estimated tax payments on 95 percent (rather than 90 percent) of its current year tax liability, whether such liability is determined on an actual or annualized basis.

The proposal would not change the present-law availability of the 100 percent of last year's liability safe harbor for large or small corporations.

Effective Date

The proposal would be effective for estimated tax payments with respect to taxable years beginning after December 31, 1996.

7. Modify Individual Estimated Tax Requirements

Present Law

Under present law, an individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax. An individual generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to: (1) 100 percent of the tax liability of the prior year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax liability of the current year. Income tax withholding from wages is considered to be a payment of estimated taxes.

In addition, under a special rule, for taxable years beginning after 1991 and before 1997, a taxpayer generally may not use the 100 percent of last year's liability safe harbor if (1) the taxpayer has an adjusted gross income (AGI) in the current year that exceeds the taxpayer's AGI in the prior year by more than $40,000 ($20,000 in the case of a separate return by a married individual) and (2) the taxpayer has an AGI in excess of $75,000 in the current year ($37,500 in the case of a separate return by a married individual).

Description of Proposal

The special rule that denies the use of the 100 percent of last year's liability safe harbor would be made permanent.

In addition, the proposal would clarify the application of the special rule to estates and trusts.

Effective Date

The proposal would be effective for estimated tax payments applicable to taxable years beginning after December 31, 1991.