DESCRIPTION OF CHAIRMAN'S MARK ON REVENUE RECONCILIATION PROPOSALS

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's mark on proposed revenue reconciliation provisions. The Senate Committee on Finance is scheduled to mark up revenue reconciliation provisions under the Budget Resolution for fiscal year 1994.

Part I describes the revenue-raising provisions; Part II describes investment and training provisions; Part III describes an increase in the public debt limit; and Part IV describes outlay-related revenue provisions. (A separate staff document presents the estimated budget effects of the Chairman's proposed mark relating to revenue reconciliation provisions.)

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Chairman's Mark on Revenue Reconciliation Proposals (JCX-6-93), June 17, 1993.

I. REVENUE-RAISING PROVISIONS

A. Individual Income and Estate and Gift Tax Provisions

1. Increased tax rates for higher income individuals

Present Law

Regular tax rates

For 1993, the individual income tax rates are as follows--

If taxable income is:	Then income tax equals:
Single individuals	
\$0-\$22,100	15 percent of taxable income.
\$22,100-\$53,500	\$3,315.00 plus 28% of the amount over \$22,100.
Over \$53,500	\$12,107.00 plus 31% of the amount over \$53,500.
Heads of household	
\$0-\$29,600	15 percent of taxable income.
\$29,600-\$76,400	\$4,440.00 plus 28% of the amount over \$29,600.
Over \$76,400	\$17,544.00 plus 31% of the amount over \$76,400.
Married individuals filing joint returns	
\$0-\$36,900	15 percent of taxable income.
\$36,900-\$89,150	\$5,535 plus 28% of the amount over \$36,900.
Over \$89,150	\$20,165 plus 31% of the amount over \$89,150.
Married individuals filing separate returns	
\$0-\$18,450	15 percent of taxable income.
\$18,450-\$44,575	\$2,767.50 plus 28% of the amount over \$18,450.
Over \$44,575	\$10,082.50 plus 31% of the amount over \$44,575.
Estates and trusts	
\$0-\$3,750	15 percent of taxable income.
\$3,750-\$11,250	\$562.50 plus 28% of the amount over \$3,750.
Over \$11,250	\$2,662.50 plus 31% of the amount over \$11,250.

Net capital gains income is subject to a maximum tax rate of 28 percent.

The individual income tax brackets are indexed each year for inflation.

Alternative minimum tax

An individual taxpayer is subject to an alternative minimum tax (AMT) to the extent that the taxpayer's tentative minimum tax exceeds the taxpayer's regular tax liability. A taxpayer's tentative minimum tax generally equals 24 percent of alternative minimum taxable income (AMTI) in excess of an exemption amount. The exemption amount is $40,000 for married taxpayers filing joint returns, $30,000 for unmarried taxpayers filing as single or head of household, and $20,000 for married taxpayers filing separate returns, estates, and trusts. The exemption amount is phased out for taxpayers with AMTI above specified thresholds. These thresholds are: $150,000 for married taxpayers filing joint returns, $112,500 for unmarried taxpayers filing as single or head of household, and $75,000 for married taxpayers filing separate returns, estates, and trusts. The exemption is completely phased out for individuals with AMTI above $310,000 (married taxpayers filing joint returns) or $232,500 (unmarried taxpayers filing as single or head of household).

Surtax on higher-income taxpayers

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

Itemized deduction limitation

Under present law, individuals who do not elect the standard deduction may claim itemized deductions (subject to certain limitations) for certain expenses incurred during the taxable year. Among these deductible expenses are unreimbursed medical expenses, unreimbursed 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, unreimbursed 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 $108,450 in 1993 (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.

Personal exemption phaseout

Present law permits a personal exemption deduction from gross income for an individual, the individual's spouse, and each dependent. For 1993, the amount of this deduction is $2,350 for each exemption claimed. This exemption amount is adjusted for inflation. The deduction for personal exemptions is phased out for taxpayers with AGI above a threshold amount (indexed for inflation) which is based on filing status. For 1993, the threshold amounts are $162,700 for married taxpayers filing joint returns, $81,350 for married taxpayers filing separate returns, $135,600 for unmarried taxpayers filing as head of household, and $108,450 for unmarried taxpayers filing as single.

The total amount of exemptions that 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 2 percent for each $1,250 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, 1996.

Description of Proposal

New marginal tax rates

The proposal would impose a new 36-percent marginal tax rate on taxable income in excess of the following thresholds:

Filing status	Applicable threshold
Married individuals filing joint returns	$140,000
Heads of households	$127,500
Unmarried individuals	$115,000
Married individuals filing separate returns	$ 70,000
Estates and trusts	$ 5,500

For estates and trusts, the 15-percent rate would apply to income up to $1,500, the 28-percent rate would apply to income between $1,500 and $3,500, and the 31-percent rate would apply to income between $3,500 and $5,500. Under this modified tax rate schedule for estates and trusts, the benefits of the rates below the 39.6-percent surtax-included rate (described below) for 1993 would approximate the benefits of the 15- and 28-percent rates for 1993 under present law.

For taxable years beginning in 1993, a blended rate (described below) would be used.

As under present law, the tax rate bracket thresholds would be indexed for inflation. However, indexing of thresholds for the 36-percent rate would apply to taxable years beginning after December 31, 1994.

Alternative minimum tax

The proposal would provide a two-tiered graduated rate schedule for the AMT for taxpayers other than corporations. A 26-percent rate would apply to the first $175,000 of a taxpayer's AMTI in excess of the exemption amount, and a 28-percent rate would apply to AMTI more than $175,000 above the exemption amount. For married individuals filing separate returns, the 28-percent rate would apply to AMTI more than $87,500 above the exemption amount. The proposal would increase the exemption amount to $45,000 for married individuals filing joint returns, to $33,750 for unmarried individuals, and to $22,500 for married individuals filing separate returns, estates, and trusts.

Surtax on higher-income taxpayers; surtax on net capital gain

The proposal would impose a 10-percent surtax on individuals with taxable income in excess of $250,000 and on estates and trusts with taxable income in excess of $7,500. For married taxpayers filing separate returns, the threshold amount for the surtax would be $125,000. The surtax would be computed by applying a 39.6-percent rate to taxable income in excess of the applicable threshold. In a similar manner, an individual's net capital gain would be subject to the surtax by applying a maximum rate of 30.8 percent (instead of the present-law maximum rate of 28 percent) to capital gains income to the extent an individual's taxable income exceeds $250,000.

The thresholds for the surtax would be indexed for inflation in the same manner as other individual income tax rate thresholds for taxable years beginning after December 31, 1994.

Itemized deduction limitation and phaseout of personal exemptions

The proposal would make permanent the provisions that limit itemized deductions and phase out personal exemptions.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1992. For taxable years beginning in 1993, blended tax rates would be used. For taxable years beginning in 1993, the 36-percent tax rate would be reduced to 33.5 percent and the 39.6-percent rate would be reduced to 35.3 percent. In addition, the 30.8-percent maximum rate on capital gains income would be reduced to 29.4 percent for taxable years beginning in 1993. Similarly, for taxable years beginning in 1993, the 26-percent and 28-percent alternative minimum tax rates would be reduced to 25 percent and 26 percent, respectively. The permanent rate levels would be used for 1994 and later years.

Withholding tables for 1993 would not be revised to reflect the changes in tax rates. Penalties for the underpayment of estimated taxes would be waived for underpayments of 1993 taxes attributable to these changes in tax rates.

2. Provisions to prevent conversion of ordinary income to capital gain

a. Treatment of net capital gains as investment income

Present Law

In the case of a taxpayer other than a corporation, deductions for interest on indebtedness that is allocable to property held for investment ("investment interest") are limited to the taxpayer's net investment income for the taxable year. Disallowed investment interest is carried forward to the next taxable year. Investment income includes gross income (other than gain on disposition) from property held for investment and any net gain attributable to the disposition of property held for investment.

Investment interest that is allowable is deductible against income taxable at ordinary income rates. The net capital gain (i.e., net long-term capital gain less net short-term capital loss) of a noncorporate taxpayer is taxed at a maximum rate of 28 percent.

Prior to 1986, when a significant rate differential existed between long-term capital gains and ordinary income, long-term capital gains were not included in investment income for purposes of computing the investment interest limitation.

Description of Proposal

The proposal generally would exclude net capital gain attributable to the disposition of property held for investment from investment income for purposes of computing the investment interest limitation. A taxpayer, however, could elect to include so much of his net capital gain in investment income as the taxpayer chooses if he also reduces the amount of net capital gain eligible for the 28-percent maximum capital gains rate by the same amount.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1992.

b. Definition of "substantially appreciated" inventory

Present Law

Under present law, amounts received by a partner in exchange for his interest in a partnership are treated as ordinary income to the extent they are attributable to substantially appreciated inventory of the partnership. In addition, distributions by a partnership in which a partner receives substantially appreciated inventory in exchange for his interest in certain other partnership property (or receives certain other property in exchange for

substantially appreciated inventory) are treated as a taxable sale or exchange of property, rather than as a nontaxable distribution.

For these purposes, inventory is treated as substantially appreciated if the value of the partnership's inventory exceeds both 120 percent of its adjusted basis and 10 percent of the value of all partnership property (other than money).

Description of Proposal

The proposal would eliminate the requirement that the partnership's inventory exceed 10 percent of the value of all partnership property in order to be substantially appreciated. Thus, if the partnership's inventory is worth more than 120 percent of its adjusted basis, the inventory would be treated as substantially appreciated. In addition, any inventory property acquired with a principal purpose to reduce the appreciation to less than 120 percent in order to avoid ordinary income treatment would be disregarded in applying the 120-percent test.

Effective Date

The proposal would apply to sales, exchanges, and distributions after April 30, 1993.

c. Repeal of certain exceptions to the market discount rules

Present Law

Generally, a market discount bond is a bond that is acquired for a price that is less than the principal amount of the bond.[1] Market discount generally arises when the value of a debt obligation declines after issuance (typically, because of an increase in prevailing interest rates or a decline in the credit-worthiness of the borrower).

Gain on the disposition of a market discount bond generally must be recognized as ordinary income to the extent of the market discount that has accrued. This ordinary income rule, however, does not apply to tax-exempt obligations or to market discount bonds issued on or before July 18, 1984. Under current law, income attributable to accrued market discount on tax-exempt bonds is not tax-exempt but is taxable as capital gain if the bond is held as a capital asset.

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[1] Or, in the case of a bond issued with original issue discount (OID), a price that is less than the amount of the issue price plus accrued OID.

Description of Proposal

The proposal would extend the ordinary income rule to tax-exempt obligations and to market discount bonds issued on or before July 18, 1984. Thus, gain on the disposition of a tax-exempt obligation or any other market discount bond that is acquired for a price that is less than the principal amount of the bond generally would be treated as ordinary income (instead of capital gain) to the extent of accrued market discount.

Effective Date

The proposal would be effective for bonds purchased after April 30, 1993. Thus, current owners of tax-exempt bonds and other market discount bonds issued on or before July 18, 1984, would not be required to treat accrued market discount as ordinary income, if they acquired their bonds before May 1, 1993.

d. Accrual of income by holders of stripped preferred stock

Present Law

In general, if a bond is issued at a price approximately equal to its redemption price at maturity, the expected return to the holder of the bond is in the form of periodic interest payments. In the case of original issue discount ("OID") bonds, however, the issue price is below the redemption price, and the holder receives part or all of his expected return in the form of price appreciation. The difference between the issue price and the redemption price is the OID, and a portion of the OID is required to be accrued and included in the income of the holder annually. Similarly, for certain preferred stock that is issued at a discount from its redemption price, a portion of the redemption premium must be included in income annually.

A stripped bond (i.e., a bond issued with interest coupons some of which are subsequently "stripped" so that the ownership of the bond is separated from the ownership of the interest coupons) generally is treated as a bond issued with OID equal to (1) the stated redemption price of the bond at maturity minus (2) the amount paid for the stripped bond.

If preferred stock is stripped of some of its dividend rights, however, the stripped stock is not subject to the rules that apply to stripped bonds or to the rules that apply to bonds and certain preferred stock issued at a discount.

Description of Proposal

The proposal would treat the purchaser of stripped preferred stock (and a person who strips preferred stock and disposes of the stripped dividend rights) in generally the same way that the purchaser of a stripped bond would be treated under the OID rules.

Thus, stripped stock would be treated like a bond issued with OID equal to (1) the stated redemption price of the stock minus (2) the amount paid for the stock. The discount accrued under the provision would be treated as ordinary income and not as interest or dividends.

Stripped preferred stock is defined as any preferred stock where the ownership of the stock has been separated from the right to receive any dividend that has not yet become payable. The provision applies to stock that is limited and preferred as to dividends, does not participate in corporate growth to any significant extent, and has a fixed redemption price.

No inference is intended as to the treatment of stripped preferred stock for tax purposes with respect to any issues not directly addressed by this legislation, including the availability of the dividends received deduction to a holder of dividends stripped from preferred stock, the allocation of basis by the creator of stripped preferred stock, or the proper characterization of a purported sale of stripped dividend rights.

Effective Date

The proposal would be effective for stripped stock that is purchased after April 30, 1993.

e. Recharacterization of capital gain as ordinary income for certain financial transactions

Present Law

Under present law, the maximum rate of individual income tax on ordinary income is 31 percent. Interest from a loan generally is treated as ordinary income.

Gain or loss from the sale or exchange of a capital asset generally is treated as capital gain or loss. Net capital gain (i.e., net long-term capital gain less net short-term capital loss) of an individual is subject to a maximum tax rate of 28 percent. Generally, capital losses are not deductible against ordinary income.

Description of Proposal

Under the proposal, capital gain from the disposition of any position that was part of a "conversion transaction" would be recharacterized as ordinary income,[2] with certain limitations discussed below. No inference is intended as to when income from

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[2] This ordinary income will continue to be treated as gain from the sale of property for purposes such as the unrelated business income tax for tax-exempt organizations and the gross income requirement for regulated investment companies.

a conversion transaction is properly treated as capital gain under present law.

A conversion transaction is a transaction, generally consisting of two or more positions taken with regard to the same or similar property, where substantially all of the taxpayer's return is attributable to the time value of the taxpayer's net investment in the transaction. In a conversion transaction, the taxpayer is in the economic position of a lender -- he has an expectation of a return from the transaction which in substance is in the nature of interest and he undertakes no significant risks other than those typical of a lender.

A transaction, however, is not a conversion transaction subject to the provision unless it also satisfies one of the following four criteria: (1) the transaction consists of the acquisition of property by the taxpayer and a substantially contemporaneous agreement to sell the same or substantially identical property in the future; (2) the transaction is a straddle, within the meaning of section 1092[3]; (3) the transaction is one that was marketed or sold to the taxpayer on the basis that it would have the economic characteristics of a loan but the interest-like return would be taxed as capital gain; or (4) the transaction is described as a conversion transaction in regulations to be promulgated on a prospective basis by the Secretary of the Treasury. Certain transactions of an options dealer or a commodities trader in the normal course of its activity of dealing in options or commodities, respectively, also would not be considered to be conversion transactions. Special rules would limit the availability of this exception for limited partners or limited entrepreneurs of an options dealer or a commodities trader.

Under the proposal, gain realized by a taxpayer from a conversion transaction that would otherwise be treated as capital gain would be treated as ordinary income (but not as interest) for all purposes of the Internal Revenue Code. The amount of gain so recharacterized would not exceed the amount of interest that would have accrued on the taxpayer's net investment for the relevant period at a yield equal to 120% of the "applicable rate". This limit would be subject to appropriate reduction to reflect prior inclusion of ordinary income items from the conversion transaction or the capitalization of interest on acquisition indebtedness under section 263(g). The "applicable rate" would be the applicable Federal rate under section 1274(d) at the time the taxpayer enters into the conversion transaction (if the conversion transaction has a definite term) or the Federal short term rate determined under section 6621(b) (if the conversion transaction has an indefinite term).

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[3] Except that stock also is treated as personal property in defining a straddle for purposes of the conversion transaction provision.

Effective Date

The proposal would be effective for conversion transactions entered into after April 30, 1993.

3. Repeal health insurance wage base cap

Present Law

As part of the Federal Insurance Contributions Act (FICA), a tax is imposed on employees and employers up to a maximum amount of employee wages. The tax is comprised of two parts: old-age, survivor, and disability insurance (OASDI) and Medicare hospital insurance (HI). For wages paid in 1993 to covered employees, the HI tax rate is 1.45 percent on both the employer and the employee on the first $135,000 of wages and the OASDI tax rate is 6.2 percent on both the employer and the employee on the first $57,600 of wages.

Under the Self-Employment Contributions Act of 1954 (SECA), a tax is imposed on an individual's self-employment income. The self-employment tax rate is the same as the total rate for employers and employees (i.e., 2.9 percent for HI and 12.40 percent for OASDI). For 1993, the HI tax is applied to the first $135,000 of self-employment income and the OASDI tax is applied to the first $57,600 self-employment income. In general, the tax is reduced to the extent that the individual had wages for which employment taxes were withheld during the year.

The cap on wages and self-employment income subject to FICA and SECA taxes is indexed to changes in the average wages in the economy.

Description of Proposal

The proposal would repeal the dollar limit on wages and self-employment income subject to HI taxes.

Effective Date

The proposal would be effective for wages and income received after December 31, 1993.

4. Reinstate top estate and gift tax rates at 53 percent and 55 percent

Present Law

A Federal gift tax is imposed on transfers by gift during life and a Federal estate tax is imposed on transfers at death. The Federal estate and gift taxes are unified, so that a single graduated rate schedule is applied to an individual's cumulative gifts and bequests. For decedents dying (or gifts made) after 1992, the estate and gift tax rates begin at 18 percent on the first $10,000 of taxable transfers and reach a maximum of 50 percent on taxable transfers over $2.5 million. Previously, for the nine-year period beginning after 1983 and ending before 1993, two additional brackets applied at the top of the rate schedule: a rate of 53 percent on taxable transfers exceeding $2.5 million and below $3 million, and a maximum marginal tax rate of 55 percent on taxable transfers exceeding $3 million. The generation-skipping transfer tax is computed by reference to the maximum Federal estate tax rate (sec. 2641).

In order to phase out the benefit of the graduated brackets and unified credit, the estate and gift tax is increased by five percent on cumulative taxable transfers between $10 million and $18,340,000, for decedents dying and gifts made after 1992. (Prior to 1993, this phase out of the graduated rates and unified credit applied to cumulative taxable transfers between $10 million and $21,040,000.)

Description of Proposal

Under the proposal, the estate and gift tax rate would be 53 percent for taxable transfers over $2.5 million but not over $3 million. For taxable transfers over $3 million, the estate and gift tax rate would be 55 percent. The phase out of the graduated rates and unified credit would apply with respect to cumulative taxable transfers between $10 million and $21,040,000. Also, since the generation-skipping transfer tax is computed by reference to the maximum Federal estate tax rate, the rate of tax on generation-skipping transfers under the provision would be 55 percent.

Effective Date

The proposal would be effective for decedents dying, gifts made, and generation skipping transfers occurring after December 31, 1992.

5. Reduce deductible portion of business meals and entertainment expenses to 50 percent

Present Law

In general, a taxpayer is permitted a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business and, in the case of an individual, for the production of income. No deduction generally is allowed for personal, living, or family expenses.

Meal and entertainment expenses incurred for business or investment reasons are deductible if certain legal and substantiation requirements are met. The amount of the deduction generally is limited to 80 percent of the expense that meets these requirements. No deduction is allowed, however, for meal or beverage expenses that are lavish or extravagant under the circumstances.

Description of Proposal

The proposal would reduce the deductible portion of otherwise allowable business meals and entertainment expenses from 80 percent to 50 percent. In addition, the substantiation threshold for business meals would be reduced from $25 to $20.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1993.

6. Deny deduction for club dues

Present Law

No deduction is permitted for club dues unless the taxpayer establishes that his or her use of the club was primarily for the furtherance of the taxpayer's trade or business and the specific expense was directly related to the active conduct of that trade or business (Code sec. 274(a)). No deduction is permitted for an initiation or similar fee that is payable only upon joining a club if the useful life of the fee extends over more than one year. Such initial fees are nondeductible capital expenditures.[1]

Description of Proposal

Under the proposal, no deduction would be permitted for club dues. This rule would apply to all types of clubs, including business, social, athletic, luncheon, and sporting clubs. Specific business expenses (e.g., meals) incurred at a club would be deductible only to the extent they otherwise satisfy the standards for deductibility.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1993.

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[1] *Kenneth D. Smith*, 24 TCM 899 (1965).

7. Deny deduction for executive pay over $1 million

Present Law

The gross income of an employee includes any compensation received for services rendered. An employer is allowed a corresponding deduction for reasonable salaries and other compensation. Whether compensation is reasonable is determined on a case-by-case basis. However, the reasonableness standard has been used primarily to limit payments by closely-held companies where nondeductible dividends may be disguised as deductible compensation.

Description of Proposal

In general

Under the 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 of a publicly held corporation would be limited to no more than $1 million per year.

Definition of publicly held corporation

For this purpose, a corporation would be treated as publicly held if the corporation has a class of common equity securities that is required to be registered under section 12 of the Securities Exchange Act of 1934.

Covered employees

Covered employees would be defined by reference to the Securities and Exchange Commission (SEC) rules governing disclosure of executive compensation. Thus, with respect to a taxable year, a person would be a covered employee if (1) as of the close the taxable year the employee is the chief executive officer of the corporation (or an individual acting in such capacity) or (2) the employee's total compensation is required to be reported for the taxable year under the Securities Exchange Act of 1934 because the employee is one of the four highest compensated officers for the taxable year (other than the chief executive officer).

Compensation subject to the deduction limitation

In general

Unless specifically excluded, the deduction limitation would apply to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash. If an individual is a covered employee for a taxable year, the deduction limitation would apply to all compensation not explicitly excluded from the deduction limitation, regardless of whether the compensation is for services as a covered

employee. The $1 million cap would be reduced by excess parachute payments (as defined in sec. 280G) that are not deductible by the corporation.

The deduction limitation would apply when the deduction would otherwise be taken. Thus, for example, in the case of a nonqualified stock option, the deduction is normally taken in the year the option is exercised, even though the option was granted with respect to services performed in a prior year.[1]

Certain types of compensation would not be subject to the deduction limit and would not be taken into account in determining whether other compensation exceeds $1 million. The following types of compensation would not be taken into account: (1) remuneration payable on a commission basis; (2) remuneration payable solely on account of the attainment of one or more performance goals if certain independent director and shareholder approval requirements are met; (3) payments to a tax-qualified retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive's gross income (such as employer-provided health benefits and miscellaneous fringe benefits (sec. 132)); and (5) any remuneration payable under a written binding contract which was in effect on February 17, 1993, and all times thereafter before such remuneration was paid and which was not modified thereafter in any material respect before such remuneration was paid.

Commissions

In order to qualify for the exception for compensation paid in the form of commissions, the commission would have to be payable solely on account of income generated directly by the individual performance of the executive receiving such compensation. Thus, for example, compensation that equals a percentage of sales made by the executive would qualify for the exception. Remuneration would not fail to be attributable directly to the executive merely because in generating the income the executive utilizes support services, such as secretarial or research services. However, if compensation is paid on account of broader performance standards, such as income produced by a business unit of the corporation, the compensation would not qualify for the exception because it would not be paid with regard to income that is directly attributable to the individual executive.

Other performance-based compensation

Compensation would qualify for the exception for performance-based compensation only if (1) the compensation is paid solely on account of the attainment of one or more performance goals, (2) the performance goals are established by a compensation committee

[1] Of course, if at the time the options are exercised the executive is no longer a covered employee, then the deduction limitation would not apply.

consisting solely of two or more independent directors, (3) the material terms under which the compensation is to be paid, including the performance goals, is disclosed to and approved by the shareholders in a separate vote prior to payment, and (4) prior to payment, the compensation committee certifies that the performance goals and any other material terms were in fact satisfied by the executive.

Compensation would not be treated as paid solely on account of the attainment of one or more performance goals unless it is paid pursuant to a preestablished objective formula or standard. What constitutes a performance goal would be broadly defined, and would include, for example, any performance standard that is applied to the individual executive, a business unit (e.g., a division or a line of business), or the corporation as a whole. Performance standards could include, for example, increases in stock price, market share, or earnings per share. Compensation would not qualify for the performance-based exception if the executive had a right to receive the compensation notwithstanding the failure of the compensation committee to certify attainment of the performance goal or without shareholder approval.

The shareholder approval requirement would be met if, after disclosure of material terms, the compensation were approved by a majority of shares voting in a separate vote.

In the case of compensation paid pursuant to a plan, the shareholder approval requirement generally would be satisfied if the shareholders approve the terms of the plan and the class of executives to which it applies and the amount of compensation payable under the plan is not subject to discretion. Further shareholder approval of payments under the plan would not be required after the plan had been approved. Of course, if there were material changes to the plan shareholder approval would have to be obtained again in order for the exception to apply to payments under the modified plan.

Compensation payable under a binding contract

The exception for remuneration paid pursuant to a binding written contract would cease to apply to amounts paid after there has been a material modification to the terms of the contract.

Effective Date

The proposal would apply to compensation that is otherwise deductible by the corporation in a taxable year beginning on or after January 1, 1994.

8. Reduce compensation taken into account for qualified retirement plan purposes

Present Law

Under present law, the amount of a participant's compensation that can be taken into account under a tax-qualified pension plan is limited (sec. 401(a)(17)). The limit applies for determining the amount of the employer's deduction for contributions to the plan as well as for determining the amount of the participant's benefits. The limit on includible compensation is $235,840 for 1993, and is adjusted annually for inflation. The limit in effect at the beginning of a plan year applies for the entire plan year. The indexed limit in effect for a plan year does not apply to any prior plan years.

Description of Proposal

Under the proposal, the limit on compensation taken into account under a qualified plan (sec. 401(a)(17)) would be reduced to $150,000. This limit would be indexed for cost-of-living adjustments in increments of $10,000. Corresponding changes also would be made to other provisions (secs. 404(l), 408(k)(3)(C), (6)(D)(ii), and (8), and 505(b)(7)) that take into account the section 401(a)(17) limit.

Effective Date

The proposal would be generally effective for benefits accruing in plan years beginning after December 31, 1993. Special transition rules would apply in the case of governmental plans and plans maintained pursuant to a collective bargaining agreement.

In the case of an eligible participant in a plan maintained by a State or local government, the limit on compensation taken into account would be the greater of the limit under the proposal and the compensation allowed to be taken into account under the plan as in effect on July 1, 1993. For purposes of this rule, an eligible participant is an individual who first became a participant in the plan during a plan year beginning before the first plan year beginning after the earlier of: (1) the plan year in which the plan is amended to reflect the proposal, or (2) December 31, 1995. This special rule would not apply unless the plan is amended to incorporate the dollar limit in effect under section 401(a)(17) by reference, effective with respect to persons other than eligible participants for benefits accruing in plan years beginning after December 31, 1995 (or earlier if the plan amendment so provides).

In the case of a plan maintained pursuant to one or more collective bargaining agreements ratified before the date of enactment, the proposal would not apply to plan years beginning before the earlier of (1) the latest of (a) January 1, 1994, (b) the date on which the last of such collective bargaining agreements terminates (without regard to any extension or modification on or

after the date of enactment), or (c) in the case of a plan maintained pursuant to collective bargaining under the Railway Labor Act, the date of execution of an extension or replacement of the last of such collect bargaining agreements in effect on the date of enactment, or (2) January 1, 1997.

9. Deduction for moving expenses

Present Law

An employee or self-employed individual may claim a deduction from gross income for certain expenses incurred as a result of moving to a new residence in connection with beginning work at a new location (sec. 217). The deduction is not subject to the floor that generally limits a taxpayer's allowable miscellaneous itemized deductions to those amounts that exceed two percent of his adjusted gross income. Any amount received directly or indirectly by such individual as a reimbursement of moving expenses must be included in the taxpayer's gross income as compensation (sec. 82). The taxpayer may offset this income by deducting the moving expenses that would otherwise qualify as deductible items under section 217.

Deductible moving expenses are the expenses of transporting the taxpayer and members of the taxpayer's household, as well as household goods and personal effects, from the old residence to the new residence; the cost of meals and lodging enroute; the expenses for pre-move househunting trips; temporary living expenses for up to 30 days in the general location of the new job; and certain expenses related to either the sale of or settlement of a lease on the old residence or the purchase of or the acquisition of a lease on a new residence in the general location of the new job.

The moving expense deduction is subject to a number of limitations. A maximum of $1,500 can be deducted for pre-move househunting and temporary living expenses in the general location of the new job. A maximum of $3,000 (reduced by any deduction claimed for househunting or temporary living expenses) can be deducted for certain qualified expenses for the sale or purchase of a residence or settlement or acquisition of a lease. If both a husband and wife begin new jobs in the same general location, the move is treated as a single commencement of work. If a husband and wife file separate returns, the maximum deductible amounts available to each are one-half the amounts otherwise allowed.

Also, for a taxpayer to claim a moving expense deduction, the taxpayer's new principal place of work has to be at least 35 miles farther from the taxpayer's former residence than was his or her former principal place of work (or at least 35 miles from the taxpayer's former residence, if the taxpayer has no former place of work).

Description of Proposal

The proposal would exclude from the definition of moving expenses: (1) the costs of meals consumed while traveling and while living in temporary quarters near the new workplace, and (2) the costs of selling (or settling an unexpired lease on) the old

residence and buying (or acquiring a lease on) the new residence.[1] In addition, an overall $10,000 cap would be imposed on allowable moving expenses (including expenses subject to the limit on househunting and temporary living expenses) for each qualified move (including foreign moves). The $10,000 amount would be indexed for inflation occurring after December 31, 1993.

Effective Date

Generally the proposal would be effective for expenses incurred after December 31, 1993.

[1] These amounts may generally be capitalized into the basis of the underlying asset.

10. Modify estimated tax requirements for individuals

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 shown on the return of the individual for the preceding year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year. Income tax withholding from wages is considered to be a payment of estimated taxes. For estimated tax purposes, some trusts and estates are treated as individuals.

In addition, for taxable years beginning after 1991 and before 1997, a special rule provides the 100 percent of last year's liability safe harbor generally is not available to a taxpayer that (1) has a modified adjusted gross income (AGI) in the current year that exceeds the taxpayer's AGI in the preceding year by more than $40,000 ($20,000 in the case of a separate return by a married individual) and (2) has a modified 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 repealed for taxable years beginning after 1993. However, the 100 percent of last year's liability safe harbor would be modified to be a 110 percent of last year's liability safe harbor for any individual with an AGI of more than $150,000 (more than $75,000 in the case of a married individual filing a separate return in the current year) as shown on the return for the preceding taxable year. For this purpose, the AGI of a trust or an estate would be determined pursuant to rules similar to those in Code section 67(e).

For taxable years beginning after 1993, the proposal would not change the availability of (1) the 100 percent of last year's liability safe harbor for an individual with a preceding year AGI of $150,000 or less, or (2) the present-law rule that allows any individual to base estimated tax payments on 90 percent of the tax shown on the return for the current year.

Effective Date

The proposal would be effective for estimated tax payments applicable to taxable years beginning after December 31, 1993.

11. Increase taxable portion of Social Security and Railroad Retirement Tier 1 benefits

Present Law

Under present law, a portion of Social Security and Railroad Retirement Tier 1 benefits is includible in gross income for taxpayers whose provisional incomes exceed a threshold amount. For purposes of this computation, a taxpayer's provisional income includes modified adjusted gross income (adjusted gross income plus tax-exempt interest plus certain foreign source income) plus one-half of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit. The threshold amount is $25,000 for unmarried taxpayers, $32,000 for married taxpayers filing joint returns, and $0 for married taxpayers filing separate returns. A taxpayer is required to include in gross income the lesser of: (1) 50 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit, or (2) 50 percent of the excess of the taxpayer's provisional income over the applicable threshold amount.

Description of Proposal

The proposal would create a second tier of Social Security benefit inclusion in gross income. Present-law inclusion rules would apply to taxpayers with provisional income below $32,000 for unmarried taxpayers, $40,000 for married taxpayers filing joint returns, or $0 for married taxpayers filing separate returns.

For taxpayers with provisional incomes above these higher thresholds, gross income would include the lesser of:

(1) 85 percent of the taxpayer's Social Security benefit or

(2) the sum of:

(a) the smaller of (i) the amount included under present law; or (ii) $3,750 (for unmarried taxpayers) or $4,000 (for married taxpayers filing joint returns),[1]

plus,

(b) 85 percent of the excess of the taxpayer's provisional income over the applicable new threshold amounts.

A taxpayer's provisional income for purposes of this computation (modified adjusted gross income plus one-half of the

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[1] These figures equal 50 percent of the difference between the present law thresholds for 50 percent Social Security benefit inclusion and the proposed new thresholds for 85 percent Social Security benefit inclusion.

taxpayer's Social Security or Railroad Retirement Tier 1 benefit) would be calculated the same as under present law.

Revenues from the income taxation of Social Security and Railroad Retirement Tier 1 benefits attributable to the increased portion of benefits included in gross income would be transferred to the Medicare Hospital Insurance (HI) Trust Fund.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1993.

B. Business Provisions

1. Increase corporate tax rate for taxable income over $10 million

Present Law

The maximum rate of tax on the taxable income of corporations is 34 percent. The maximum rate of tax on corporate net capital gains is also 34 percent. This rate applies to income in excess of $75,000. Rates of 15- and 25- percent apply to taxable income ranges below $75,000. A corporation with taxable income in excess of $100,000 is required to increase its tax liability by the lesser of 5 percent of the excess or $11,750. This increase in tax phases out the benefits of the 15- and 25-percent rates for corporations with taxable income between $100,000 and $335,000; a corporation with taxable income in excess of $335,000, in effect, pays tax at a flat 34-percent rate.

Description of Proposal

The proposal would provide a new 35-percent marginal tax rate on corporate taxable income in excess of $10 million. The maximum rate of tax on corporate net capital gains would also be 35 percent.

A corporation with taxable income in excess of $15 million would be required to increase its tax liability by the lesser of 3 percent of the excess or $100,000. This increase in tax would recapture the benefits of the 34-percent rate in a manner analogous to the recapture of the benefits of the 15- and 25-percent rates.

Effective Date

The 35-percent marginal rate would be effective for taxable years beginning on or after January 1, 1993. Under existing law provisions regarding changes in tax rates during a taxpayer's taxable year (Code sec. 15), a fiscal year corporation would be required to use a "blended rate" for a taxable year that includes but does not begin on January 1, 1993. Accordingly, the corporation's tax liability would be a weighted average of the tax resulting from applying the existing corporate rate schedule and the tax resulting from applying the changes described above, weighted by the number of days in the taxable year before and after January 1, 1993.

Penalties for the underpayment of estimated taxes would be waived for underpayments of 1993 taxes attributable to the changes in tax rates.

2. Deny deduction for lobbying expenses

Present Law

Trade or business expenses

Taxpayers engaged in a trade or business generally are allowed a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on such trade or business (sec. 162). Present-law section 162(e)(1) specifically provides a deduction for certain so-called "direct lobbying" expenses (including travel expenses, costs of preparing testimony, and a portion of dues) paid in carrying on a trade or business if such expenses are (1) in direct connection with appearances before, submissions of statements to, or sending communications to, the committees, or individual members, of Congress or of any legislative body of a State, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the taxpayer, or (2) in direct connection with communication of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization.[1]

Section 162(e)(2) provides, however, that no deduction is allowed for any amount paid (whether by contribution, gift, or otherwise) for participation or intervention in any political campaign (i.e., "political campaign" expenses) or if paid in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums (i.e., "grass roots lobbying").

Treasury Department regulations further provide that if expenditures for lobbying purposes do not meet the requirements of section 162(e)(1), then such expenditures are not deductible as ordinary and necessary business expenses (Treas. Reg. sec. 1.162-

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[1] Prior to 1963, Treasury Department regulations (originally dating back to 1915) provided that _all_ expenditures for lobbying purposes, for the promotion or defeat of legislation, for political campaign purposes, or for propaganda (including advertising) related to any such purposes, were not deductible as "ordinary and necessary" business expenses. See _Cammarano v. United States_, 358 U.S. 498 (1959)(upholding validity of regulation denying deduction for lobbying expenses, even if expenses related to proposed legislation that affected the very survival of the taxpayer's business). In response to the _Cammarano_ decision, Congress enacted, as part of the Revenue Act of 1962, the statutory rule contained in section 162(e)(1) specifically allowing a deduction for certain "direct lobbying" expenses.

20(c)(1)).[2] The regulations provide, however, that expenditures for institutional or "good will" advertising which keeps the taxpayer's name before the public are generally deductible, provided such expenditures are related to the patronage the taxpayer might reasonably expect in the future (Treas. Reg. sec. 1.162-20(a)(2)).[3]

Rules governing lobbying by tax-exempt organizations

Non-charitable tax-exempt organizations.--Although most tax-exempt organizations other than charitable organizations (e.g., social welfare organizations and trade associations) generally may engage in unlimited lobbying efforts, some restrictions do exist. If political campaign or grass roots lobbying activities constitute a substantial part of the activities of an organization, such as a labor union or a trade association, the portion of dues or other payments to the organization that is attributable to such activities cannot be deducted by the payor under section 162.

Charitable organizations.--A charitable organization otherwise described in section 501(c)(3) is not entitled to tax-exempt status under that section if a substantial part of its activities is "carrying on propaganda, or otherwise attempting, to influence legislation."[4] There is no statutory definition under section 501(c)(3) of "propaganda, or otherwise attempting, to influence legislation," but Treasury regulations provide that an organization will be regarded as "attempting to influence legislation" if it (1) contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation, or (2) advocates the adoption or rejection of legislation (meaning action by Congress or another legislative body). Treas. Reg. sec. 1.501(c)(3)-1(c)(3). However, an organization will not fail to meet the requirements of section 501(c)(3) merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation. Id. Moreover, conducting nonpartisan research (while not advocating legislative action) is not considered lobbying for purposes of the section 501(c)(3) restriction, nor is seeking to protect the

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[2] Thus, lobbying of foreign government officials is not a deductible business expense under section 162.

[3] See also Proposed Treasury Regulation section 1.162-20(c)(4) (proposed November 25, 1980), providing a three-part test to distinguish nondeductible "grass roots" lobbying from deductible institutional advertising.

[4] See Regan v. Taxation With Representation, 461 U.S. 540 (1983)(upholding constitutionality of section 501(c)(3) lobbying restriction on grounds that legislature is not required to subsidize lobbying through a tax exemption or deduction).

organization's own existence or responding to a governmental request for testimony.[5]

For public charities making the section 501(h) election, permitted lobbying expenditures are measured against a specific arithmetical test.[6] Under section 501(h), "lobbying expenditures" are defined as "expenditures for the purpose of influencing legislation (as defined in section 4911(d))." Section 4911(d), in turn, defines the term "influencing legislation" as --

> "(A) any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof, and
>
> (B) any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation."[7]

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[5] See Rev. Rul. 70-79, 1970-1 C.B. 127; Rev. Rul. 70-449, 1970-2 C.B. 111; Slee v. Commr, 42 F.2d 184 (2d Cir. 1930).

[6] For organizations making the section 501(h) election, the allowable amount of all lobbying expenditures for any tax year is the lesser of: (1) $1 million or (2) the sum of (a) 20 percent of the first $500,000 of the organization's exempt purpose expenditures for the year, plus (b) 15 percent of the next $500,000 of such expenditures, plus (c) 10 percent of the third $500,000 of such expenditures, plus (d) five percent of any additional such expenditures. "Grass roots" lobbying expenditures are limited to 25 percent of the overall permissible lobbying amount (sec. 4911(c)). Certain affiliated organizations are treated as one organization for purposes of applying the section 501(h) arithmetical test.

Under section 501(h), if lobbying expenditures (for either all lobbying or grass roots lobbying in particular) made during a taxable year exceed the allowable amounts, an excise tax is imposed on the organization equal to 25 percent of the excess lobbying expenditures (sec. 4911(a)). If the sum of the electing organization's lobbying expenditures during a four-year period exceeds 150 percent of the sum of the allowable amounts during that period, then the organization loses its tax-exempt status under section 501(c)(3) (Treas. Reg. sec. 1.501(h)-3(b)).

[7] For purposes of section 4911, the term "legislation" includes action taken by a legislative body, meaning the "introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items" but does not include action taken by executive, judicial, or administrative bodies. See Treas. Reg. sec. 56.4911-2(d).

However, section 4911(d)(2) specifically excludes from the definition of "influencing legislation" the following activities:

> "(A) making available the results of nonpartisan analysis, study, or research[8];
>
> (B) providing of technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be[9];

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[8] Under the section 4911 regulations, "nonpartisan analysis, study, or research" means an independent and objective exposition of a particular subject matter, including any activity that is "educational" within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(3). Thus, "nonpartisan analysis, study, or research" may advocate a particular position or viewpoint so long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. The mere presentation of unsupported opinion, however, does not qualify as "nonpartisan analysis, study, or research." The determination of whether a publication or broadcast qualifies as "nonpartisan analysis, study, or research" generally is made on a presentation-by-presentation basis, but if a publication is prepared as part of a series, the series as a whole will be judged against the standards determining whether it is "nonpartisan analysis, study or research." Nonpartisan analysis may be made available to the general public, a segment thereof, or governmental bodies. Communications may not be limited to, or be directed toward, persons who are interested solely in one side of a particular issue. Treas. Reg. sec. 56.4911-2(c)(1).

Furthermore, a Treasury regulation under section 4911 provides that "[e]xaminations and discussions of broad social, economic, and similar problems are neither direct lobbying communications ... nor grass roots lobbying communications ... even if the problems are of the type with which government would be expected to deal ultimately. Thus, ... lobbying communications do not include public discussion, or communications with members of legislative bodies or governmental employees, the general subject of which is also the subject of legislation before a legislative body, so long as such discussion does not address itself to the merits of a specific legislative proposal and so long as such discussion does not directly encourage recipients to take action with respect to legislation." Treas. Reg. sec. 56.4911-2(c)(2).

[9] Under this exception, the request for assistance or advice must be made in the name of the requesting governmental body, committee, or subdivision rather than an individual member thereof;

(C) appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization;

(D) communications between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members, other than communications which directly encourage members to contact a legislative body in an attempt to influence legislation, or which directly encourage members to urge persons other than members to attempt to affect the opinions of the general public or to contact a legislative body in an attempt to influence legislation; and

(E) any communication with a government official or employee, other than --

(i) a communication with a member or employee of a legislative body (where such communication would otherwise constitute the influencing of legislation), or

(ii) a communication the principal purpose of which is to influence legislation.

Private foundations.--Private foundations (as distinguished from public charities) generally are subject to penalty excise taxes under section 4945 if they engage in any direct or grass roots lobbying, even if not substantial. For purposes of section 4945, lobbying is defined in a manner similar to the definition under section 4911(d). Specifically, the section 4945 penalty excise taxes do not apply to nonpartisan analysis, the provision of

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and the response to such request must be made available to every member of the requesting body, committee, or subdivision. Treasury regulations further provide that because such assistance or advice may be given only at the express request of a governmental body, the oral or written presentation of such assistance or advice need not qualify as nonpartisan analysis, study or research. The offering of opinions or recommendations will ordinarily qualify under this exception only if such opinions or recommendations are specifically requested by the governmental body or are directly related to the materials so requested (Treas. Reg. secs. 56.4911-2(c)(3) and 53.4945-2(d)(2)).

technical advice to a governmental body in response to a written request, or lobbying before a legislative body with respect to a possible decision of such body which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation (sec. 4945(e)).

Description of Proposal

Under the proposal, no deduction would be allowed for amounts paid for certain lobbying activities before Congress and Federal agencies, as well as State and local legislative bodies.[10] The present-law rule disallowing business deductions for expenses of grass roots lobbying and participation in political campaigns also would remain in effect.

General rule

The proposal would disallow the costs of any "lobbying contact," meaning (1) in the case of a "lobbyist" (as defined below), any oral or written communication with a legislative branch official or employee or certain high-ranking Federal executive branch officials[11], and (2) in the case of any other person (i.e.,

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[10] The proposal would apply to attempts to influence State and local legislation but not to attempts to influence actions of State or local executive branch or administrative bodies. For purposes of the proposal, the present-law definition of "legislation" under section 4911(e)(2) would apply, such that actions taken by zoning or school boards, or other local special-purpose bodies would not constitute "legislation" regardless of whether the members of such local special-purpose bodies are elected or appointed to their positions (Treas. reg. sec. 56.4911-2(d)(4)).

[11] The proposal would apply to the costs of communications with the following Federal executive branch officials: (1) the President; (2) the Vice President; (3) any officer or employee of the Executive Office of the President other than a clerical or secretarial employee; (4) any officer or employee serving in an Executive level I, II, III, IV, or V position, as designated in statute or Executive order (such as Secretaries, Deputy Secretaries and Assistant Secretaries, Directors, and Commissioners); (5) any officer or employee serving in a Senior Executive Service position as defined under 5 U.S.C. section 3232(a)(2); (6) any member of the uniformed services whose pay grade is at or in excess of O-7 under 37 U.S.C. section 201; and (7) any officer or employee serving in a position of confidential or policy-determining character under Schedule C of the excepted service pursuant to 5 U.S.C. section 7511. Under the Lobbying Disclosure Act of 1993 (S. 349), as passed by the Senate on May 6, 1993, such Federal executive branch officials are referred to as "covered executive branch officials," communications to whom are subject to the Act's reporting requirements.

a non-lobbyist), any oral or written communication with a legislative branch official or employee in an attempt to influence the formulation of legislation or with certain high-ranking Federal executive branch officials in an attempt to influence legislation or the formulation or administration of Federal rules, regulations, programs or policies (with certain exceptions described below).

Exceptions to general rule[12]

Exception for legislative lobbying.--The proposal would not apply to the costs of contacting a legislative branch official or employee if such contact is required by subpoena, civil investigative demand, or otherwise compelled by statute or other action of Congress or a State or local legislative body.

Exceptions for Federal executive branch lobbying.--Exceptions to the proposal's general disallowance rule for lobbying of certain high-ranking Federal executive branch officials would be provided for contacts that are (1) compelled by statute, regulation, or other action of a Federal agency, (2) communications with respect to the administration or execution of Federal programs or policies (including the award of a Federal contract, grant, or license) if such communications are made to executive branch officials in the agency responsible for taking such action who serve in the Senior Executive Service, or who are members of the uniformed services whose pay grade is lower than O-9 under 37 U.S.C. section 201, (3) written comments filed in a public docket or other communications that are made on the record in a public proceeding, (4) made in response to a notice in the Federal Register, Commerce Business Daily, or similar publication soliciting communications from the public and directed to the agency official specifically designated in the notice to receive such communications, (5) made to agency officials with regard to judicial proceedings, criminal or civil law enforcement inquiries, investigations or proceedings, or filings required by statute or regulation, (6) made in compliance with written agency procedures regarding an adjudication conducted by the agency under 5 U.S.C. section 554 (or substantially similar provisions), or (7) made on behalf of an individual with regard to such individual's benefits, employment, other personal matters involving only that individual, or disclosures by that individual pursuant to applicable whistleblower statutes.

Definition of "lobbyist"

As described above, the proposal provides a presumption that communications made by "lobbyists" to certain government officials are nondeductible lobbying. In contrast, communications made by other persons (i.e., non-lobbyists) to certain government officials are nondeductible lobbying only if such communications are made in

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[12] These exceptions (along with others not included in the proposal) are included in the Lobbying Disclosure Act of 1993 (S. 349), as passed by the Senate on May 6, 1993.

an attempt to influence legislation or certain Federal executive branch actions.[13] For purposes of the proposal, the term "lobbyist" would have a meaning similar to the definition under the Lobbying Disclosure Act of 1993 (S. 349), as passed by the Senate on May 6, 1993, and would include any person who is employed or retained by another for financial or other compensation to perform services that include any attempt to influence the formulation of legislation or the formulation or administration of Federal rules, regulations, programs, or policies (with the exceptions described above).

The definition of "lobbyist" would include both "in-house" lobbyists who are hired as employees and "outside" lobbyists who are hired as independent contractors. The term "lobbyist" would not include a person whose lobbying activities are only incidental to, and are not a significant part of, the services provided by such person to the client. Consistent with the legislative history of the Lobbying Disclosure Act of 1993, it would be intended that a person who spends less than 10 percent of his or her time for a particular client on lobbying activities for that client would not be a "lobbyist" (with regard to that client).

Under the proposal, the determination of whether an individual is a "lobbyist" would be made on a client-by-client basis. That is, a person may be a "lobbyist" for a particular client on the basis of the services provided for that client, but the same person may not be a "lobbyist" with respect to a different client.

Activities in support of lobbying

The proposal would disallow the costs of activities in support of a "lobbying contact" (as defined above), including (1) any preparation or planning activity relating to a lobbying contact (including, in the case of a lobbyist, the formulation, review, and management of the lobbying contacts on behalf of a client), (2) any research or other background work relating to a lobbying contact, and (3) any activity coordinating the lobbying activity of two or more persons.

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[13] It would be intended that the Secretary of the Treasury will provide guidance for distinguishing (1) attempts to influence legislation or certain Federal executive branch actions, from (2) mere monitoring of legislative or executive branch activities where there is no attempt to influence the formulation of legislation or executive branch regulations or policies. In cases where an individual or organization monitors legislative activities or Federal executive branch activities and subsequently attempts to influence the outcome of such legislative or Federal executive branch activities, it would be intended that the costs of the monitoring activities generally will be treated as nondeductible lobbying expenses.

In addition, the proposal would provide a per se rule that would disallow any amount paid or incurred in connection with the providing of meals, entertainment, or travel to legislative officials or employees or certain high-ranking Federal executive branch officials (or to an individual accompanying such official or employee).

Dues paid to trade associations

The proposal would provide for a flow-through rule to disallow a deduction for a portion of the membership dues (or other similar amounts) paid by a person to a tax-exempt organization (other than a charity eligible to receive tax-deductible contributions) if such dues are allocable to lobbying activities conducted by the organization. For this purpose, lobbying expenditures incurred by an organization would be treated as paid first from dues collected by the organization.

Tax-exempt organizations would be required to annually report to their members (and the IRS) the portion of membership dues allocable to lobbying activities. However, a de minimis exception would be provided, so that flow-through reporting to members or the IRS would not be required if the lobbying expenditures of the organization for the calendar year are less than $2,000.[14] Penalties could be imposed under present-law section 6721 on organizations for failing to make the required flow-through information reporting.

The Secretary of the Treasury would be granted authority to provide by regulation that the reporting requirement applicable to tax-exempt organizations will not apply where unnecessary to effectuate the purposes of the proposal (e.g., where the disallowed portion of such expenditures will not materially affect the tax liability of dues-paying members, as, for example, where a tax-exempt organization derives no more than an insubstantial portion of its dues income from persons entitled to deduct the dues in determining their taxable income).

Limited flow-through for charities

The proposal would provide for flow-through of the lobbying disallowance rule in the case of contributions, dues, or similar amounts paid to a charity eligible to receive tax-deductible contributions under section 170 to the extent that the contribution (or other amount) is attributable to amounts incurred for lobbying

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[14] For purposes of determining whether the $2,000 de minimis exception applies, an organization would be required to take into account direct expenses incurred for lobbying activities (i.e., labor and materials costs and fees paid to outsiders for lobbying) but need not take into account indirect expenses (i.e., a portion of general overhead) otherwise allocable to lobbying.

activities by the charity[15], provided that (1) the lobbying activities of the charity are of direct interest to the payor's (or a related person's) trade or business, and (2) the payor makes total payments to the charity during the year exceeding $2,000. In such cases, a portion of a contribution that otherwise may be deductible under section 170 would be disallowed.

Effective Date

The proposal would be effective for amounts paid or incurred after December 31, 1993.

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[15] Similar to the treatment of lobbying expenses incurred by trade associations, lobbying expenses incurred by charities would be treated as paid first from contributions, dues, or other amounts paid by contributors or members.

3. Mark-to-market accounting method for dealers in securities

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

In general

The proposal would provide two general rules (the "market-to-market rules") that apply to certain securities that are held by a dealer in securities. First, any such security that is inventory in the hands of the dealer would be required to be included in inventory at its fair market value. Second, any such security that is not inventory in the hands of the dealer and that is held as of the close of any taxable year would be treated as sold by the dealer for its fair market value on the last business day of the taxable year and any gain or loss would be required to be taken into account by the dealer in determining gross income for that taxable year.[1]

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[1] For purposes of the proposal, a security would be treated as sold to a person that is not related to the dealer even if the security is a contract between the dealer and a related person. Thus, for example, Code sections 267 and 707(b) would not apply to any loss that would be required to be taken into account under the proposal.

In addition, a security subject to the proposal would not be treated as sold and reacquired for purposes of Code section 1091. Section 1092 would apply to any loss recognized by the mark-to

If gain or loss is taken into account with respect to a security by reason of the second mark-to-market rule, then the amount of gain or loss subsequently realized as a result of a sale, exchange, or other disposition of the security, or as a result of the application of the mark-to-market rules, would be appropriately adjusted to reflect such gain or loss. In addition, the proposal would authorize the Treasury Department to promulgate regulations that provide for the application of the second mark-to-market rule at times other than the close of a taxable year.

Character of gain or loss

Any gain or loss taken into account under the proposal (or any gain or loss recognized with respect to a security that would be subject to the proposal if the security had been held at the close of the taxable year) generally would be treated as ordinary gain or loss. This special character rule would not apply to any security that is a hedge of a security that is not subject to the mark-to-market rules or of a position, right to income, or a liability that is not a security in the hands of the taxpayer. Anti-abuse rules would be adopted to prevent straddle opportunities.

Definitions

A dealer in securities would be defined as any taxpayer that either (1) regularly purchases securities from, or sells securities to, customers in the ordinary course of a trade or business, or (2) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

A security would be defined as: (1) any share of stock in a corporation; (2) any partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; (3) any note, bond, debenture, or other evidence of indebtedness; (4) any interest rate, currency, or equity notional principal contract (but not any other notional principal contract such as a notional principal contract that is based on the price of oil, wheat, or other commodity); and (5) any evidence of an interest in, or any derivative financial instrument in, a security described in (1) through (4) above or any currency, including any option, forward contract, short position, or any similar financial instrument in such a security or currency.

In addition, a security would be defined to include any position if: (1) the position is not a security described in the preceding paragraph; (2) the position is a hedge with respect to a security described in the preceding paragraph; and (3) before the

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market rules, but will have no effect if all offsetting positions making up the straddle are subject to the mark-to market rules.

close of the day on which the position was acquired or entered into (or such other time as the Treasury Department may specify in regulations), the position is clearly identified in the dealer's records as a hedge with respect to a security described in the preceding paragraph. A security, however, generally would not include a contract to which section 1256(a) applies, unless such contract is a hedge of a security to which the proposal would apply.

Exceptions to the mark-to-market rules

Notwithstanding the definition of security, the mark-to-market rules generally do not apply to: (1) any security that is held for investment; (2) any security which is a hedge with respect to a security that is not subject to the mark-to-market rules (i.e., any security that is a hedge with respect to a security held for investment), or (3) any security which is a hedge with respect to a position, right to income, or a liability that is not a security in the hands of the taxpayer.[2]

In addition, the exceptions to the mark-to-market rules would not apply unless the security is clearly identified in the dealer's records as being described in one of the exceptions listed above. A dealer may not treat a security that is identified as a hedge or as an investment as also held in its capacity as a dealer (thus, securities identified as qualifying for one of the exceptions to the mark-to-market rules may not be accounted for using the lower-of-cost-or-market or other inventory method of accounting). The Treasury Secretary would be authorized to issue regulations that would prevent a dealer from avoiding the mark-to-market rules by treating securities held for sale or as inventory as a security that qualifies for one of the exceptions listed above. Finally, a dealer would be required to continue to hold the security in a capacity that qualifies the security for one of the exceptions listed above.

Other rules

The uniform cost capitalization rules of section 263A and the rules of section 263(g) that require the capitalization of certain interest and carrying charges in the case of straddles would not apply to any security to which the mark-to-market rules apply because the fair market value of the security should include the costs the dealer would otherwise capitalize.

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[2] Whether or not a security or evidence of indebtedness would be marked-to-market under the applicable financial accounting rules would not be dispositive for purposes of determining whether such security or evidence of indebtedness would be treated as held for investment or as not held for sale under the proposal.

In addition, the Treasury Department would be authorized to promulgate such regulations as may be necessary or appropriate to carry out the proposal, including rules to prevent the use of year-end transfers, related persons, or other arrangements to avoid the proposal.

Effective Date

The proposal would apply to taxable years ending on or after December 31, 1993. A taxpayer that would be required to change its method of accounting to comply with the requirements of the provision is treated as having initiated the change in method of accounting and as having received the consent of the Treasury Department to make such change.

The net amount of the section 481(a) adjustment would be taken into account ratably over a 5-taxable year period beginning with the first taxable year ending on or after December 31, 1993.

To the extent that a portion of the section 481(a) adjustment of a taxpayer is attributable to the use of the LIFO inventory method of accounting for any qualified security, such portion of the adjustment would be taken into account ratably over a 15-taxable year period beginning with the first taxable year ending on or after December 31, 1993, but only if the taxpayer (or any predecessor) had utilized the LIFO inventory method for such security for more than five taxable years. For this purpose, "qualified security" would mean any security acquired (1) by a floor specialist (as defined in section 1236(d)(2)) in connection with the specialist's duties as a specialist on an exchange, but only if the security is one in which the specialist is registered with the exchange or (2) by a taxpayer who is a market maker in connection with the taxpayer's duties as market maker, but only if (a) the security is included on the National Association of Security Dealers Automated Quotation System, (b) the taxpayer is registered as a market maker in such security with the National Association of Security Dealers, and (c) as of the last day of the taxable year preceding the taxpayer's first taxable year ending on or after December 31, 1993, the taxpayer (or a predecessor of the taxpayer) has been actively engaged as a market maker in such security for a 2-year period ending on such date (or, if shorter, the period beginning 61 days after the security was listed in such quotation system and ending on such date.). The portion of the section 481(a) adjustment that is attributable to the use of the LIFO inventory method of accounting for any qualified security would be determined under the rules described in section 312(n)(4) (without regard to the effective date of such section). In addition, the portion of the section 481(a) adjustment that would be subject to the 15-year period could not exceed the taxpayer's overall section 481(a) adjustment for all securities under the proposal.

The principles of section 8.03(1) and (2) of Rev. Proc. 92-20, 1992-12 I.R.B. 10, would apply to the section 481(a) adjustment by

taking into account all securities of a dealer that are subject to the mark-to-market rules (including those securities that are not inventory in the hands of the dealer).

No addition to tax would apply to certain underpayments of estimated tax to the extent that the underpayments are attributable to the enactment of this proposal.

4. Tax Treatment of Certain FSLIC Financial Assistance

Present Law and Background

A taxpayer may claim a deduction for a loss on the sale or other disposition of property only to the extent that the taxpayer's adjusted basis for the property exceeds the amount realized on the disposition and the loss is not compensated for by insurance or otherwise (sec. 165 of the Code). In the case of a taxpayer on the specific charge-off method of accounting for bad debts, a deduction is allowable for the debt only to the extent that the debt becomes worthless and the taxpayer does not have a reasonable prospect of being reimbursed for the loss. If the taxpayer accounts for bad debts on the reserve method, the worthless portion of a debt is charged against the taxpayer's reserve for bad debts, potentially increasing the taxpayer's deduction for an addition to this reserve.

A special statutory tax rule, enacted in 1981, excluded from a thrift institution's income financial assistance received from the Federal Savings and Loan Insurance Corporation (FSLIC)[1], and prohibited a reduction in the tax basis of the thrift institution's assets on account of the receipt of the assistance. Under the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), taxpayers generally were required to reduce certain tax attributes by one-half the amount of financial assistance received from the FSLIC pursuant to certain acquisitions of financially troubled thrift institutions occurring after December 31, 1988. These special rules were repealed by FIRREA, but still apply to transactions that occurred before May 10, 1989.

Prior to the enactment of FIRREA, the FSLIC entered into a number of assistance agreements in which it agreed to provide loss protection to acquirers of troubled thrift institutions by compensating them for the difference between the book value and sales proceeds of "covered assets." "Covered assets" typically are assets that were classified as nonperforming or troubled at the time of the assisted transaction but could include other assets as well. Many of these covered assets are also subject to yield maintenance guarantees, under which the FSLIC guaranteed the acquirer a minimum return or yield on the value of the

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[1] Until it was abolished by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), FSLIC insured the deposits of its member savings and loan associations and was responsible for insolvent member institutions. FIRREA abolished FSLIC and established the FSLIC Resolution Fund (FRF) to assume all of the assets and liabilities of FSLIC (other than those expressly assumed or transferred to the Resolution Trust Corporation (RTC)). FRF is administered by the Federal Deposit Insurance Corporation (FDIC). The term "FSLIC" is used hereafter to refer to FSLIC and any successor to FSLIC.

assets. The assistance agreements also generally grant the FSLIC the right to purchase covered assets. In addition, many of the assistance agreements permit the FSLIC to order assisted institutions to write down the value of covered assets on their books to fair market value in exchange for a payment in the amount of the write-down.

Under most assistance agreements, one or more Special Reserve Accounts are established and maintained to account for the amount of FSLIC assistance owed by the FSLIC to the acquired entity. The assistance agreements generally specify the precise circumstances under which amounts with respect to covered assets are debited to an account. Under the assistance agreements, these debit entries generally are made subject to prior FSLIC direction or approval. When amounts are so debited, the FSLIC generally becomes obligated to pay the debited balance in the account to the acquirer at such times and subject to such offsets as are specified in the assistance agreement.

In September 1990, the Resolution Trust Corporation (RTC), in accordance with the requirements of FIRREA, issued a report to Congress and the Oversight Board of the RTC on certain FSLIC-assisted transactions (the "1988/89 FSLIC transactions"). The report recommended further study of the covered loss and other tax issues relating to these transactions. A March 4, 1991 Treasury Department report ("Treasury report") on tax issues relating to the 1988/89 FSLIC transactions concluded that deductions should not be allowed for losses that are reimbursed with exempt FSLIC assistance. The Treasury report states that the Treasury view is expected to be challenged in the courts and recommended that Congress enact clarifying legislation disallowing these deductions.[2]

Description of Proposal

General rule

The proposal would treat FSLIC assistance with respect to any loss of principal, capital, or similar amount upon the disposition of an asset would be taken into account as compensation for such loss for purposes of Code section 165. FSLIC assistance with respect to any debt would be taken into account under Code sections 166, 585 and 593 for purposes of determining whether such debt is worthless (or the extent to which such debt is worthless) and in determining the amount of any addition to a reserve for bad debts. For this purpose, FSLIC

[2] Department of the Treasury, Report on Tax Issues Relating to the 1988/89 Federal Savings and Loan Insurance Corporation Assisted Transactions, March 1991, pp. 16-17.

assistance means any assistance or right to assistance with respect to a domestic building and loan association (as defined in Code sec. 7701(a)(19) without regard to subparagraph (C) thereof) pursuant to section 406(f) of the National Housing Act or section 21A of the Federal Home Loan Bank Act (or under any similar provision of law).

Financial assistance to which the FIRREA amendments apply

The proposal would not apply to any financial assistance to which the amendments made by section 1401(a)(3) of FIRREA apply.

No inference

No inference would be intended as to prior law or as to the treatment of any item to which the proposal does not apply.

Effective Date

In general

The proposal would apply to financial assistance credited on or after March 4, 1991, with respect to: (1) assets disposed of and charge-offs made in taxable years ending on or after March 4, 1991; and (2) assets disposed of and charge-offs made in taxable years ending before March 4, 1991, but only for purposes of determining the amount of any net operating loss carryover to a taxable year ending on or after March 4, 1991.

For this purpose, financial assistance generally would be considered to be credited when the taxpayer made an approved debit entry to a Special Reserve Account required to be maintained under the assistance agreement to reflect the asset disposition or charge-off. An amount will also be considered to be credited prior to March 4, 1991 if the asset was sold, with prior FSLIC approval, before that date.

Application to certain net operating losses

The proposal would apply to the determination of any net operating loss carried into a taxable year ending on or after March 4, 1991, to the extent that the net operating loss is attributable to a loss or charge-off for which the taxpayer had a right to FSLIC assistance which had not been credited before March 4, 1991.

Estimated Tax Payments

The proposal would waive additions to tax for underpayments relating to certain estimated tax payments.

5. Modification of corporate estimated tax rules

Present Law

A corporation is subject to an addition to tax for any underpayment of estimated tax. For taxable years beginning after June 30, 1992, and before 1997, a corporation does not have an underpayment of estimated tax if it makes four equal timely estimated tax payments that total at least 97 percent of the tax liability shown on its return for the current taxable year. A corporation may estimate its current year tax liability prior to year-end by annualizing its income through the period ending with either the month or the quarter ending prior to the estimated tax payment due date. For taxable years beginning after 1996, the 97-percent requirement becomes a 91-percent requirement.

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 the tax liability shown on its return for the preceding taxable year. A large corporation may also 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

In general

For taxable years beginning after December 31, 1993, 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 100 percent (rather than 97 percent or 91 percent) of the tax shown on its return for the current year, whether such tax 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.

Annualization periods

In addition, the proposal would modify the rules relating to income annualization for corporate estimated tax purposes. In general, the proposal would (1) add a new, third set of periods over which corporations may elect to annualize income and (2) require corporations to annually elect which of the three periods they will use to annualize income for the year.

Specifically, under the proposal, annualized income would be determined based on the corporation's income for the first 3 months of the taxable year (in the case of the first and second estimated tax installments); the first 6 months of the taxable year (in the

case of the third estimated tax installment); and the first 9 months of the taxable year (in the case of the fourth estimated tax installment). Alternatively, a corporation may elect to determine its annualized income based on the corporation's income for either: (1) the first 2 months of the taxable year (in the case of the first estimated tax installment); the first 4 months of the taxable year (in the case of the second estimated tax installment); the first 7 months of the taxable year (in the case of the third estimated tax installment); and the first 10 months of the taxable year (in the case of the fourth estimated tax installment); or (2) the first 3 months of the taxable year (in the case of the first estimated tax installment); the first 5 months of the taxable year (in the case of the second estimated tax installment); the first 8 months of the taxable year (in the case of the third estimated tax installment); and the first 11 months of the taxable year (in the case of the fourth estimated tax installment). An election to use either of the annualized income patterns described in (1) or (2) above must be made on or before the due date of the first estimated tax installment for the taxable year for which the election is to apply, in a manner prescribed by the Secretary of the Treasury.

Effective Date

The proposal would effective for taxable years beginning after December 31, 1993.

6. Repeal the stock-for-debt exception to cancellation of indebtedness income

Present Law

Gross income generally includes cancellation of indebtedness (COD) income. Taxpayers in title 11 cases and insolvent taxpayers, however, generally exclude COD income from gross income but reduce tax attributes by the amount of COD income. The amount of COD income that an insolvent taxpayer excludes cannot exceed the amount by which the taxpayer is insolvent.

The amount of COD income generally is the difference between the adjusted issue price of the debt being cancelled and the amount of cash and the value of any property used to satisfy the debt. Thus, for purposes of determining the amount of COD income of a debtor corporation that transfers stock to a creditor in satisfaction of its indebtedness, the corporation generally is treated as realizing COD income equal to the excess of the adjusted issue price of the debt over the fair market value of the stock. However, if the debtor corporation is in a title 11 case or is insolvent, the excess of the debt discharged over the fair market value of the transferred stock generally does not constitute COD income (the "stock-for-debt exception").[1] Thus, a corporate debtor that qualifies for the stock-for-debt exception is not required to reduce its tax attributes as a result of the debt discharge. The stock-for-debt exception does not apply to the issuance of certain preferred stock, nominal or token shares of stock, or stock to unsecured creditors on a relatively disproportionate basis. In the case of an insolvent debtor not in a title 11 case, the exception applies only to the extent the debtor is insolvent.

Description of Proposal

The proposal would repeal the stock-for-debt exception. Thus, regardless of whether a debtor corporation is insolvent or in bankruptcy, the transfer of its stock in satisfaction of its indebtedness would be treated as if the corporation satisfied the indebtedness with an amount of money equal to the fair market value of the stock that had been transferred. As under present law, a bankrupt or insolvent corporation could exclude from income all or

[1] In addition, if the debtor corporation issues both stock and other consideration to a creditor in satisfaction of indebtedness, the non-stock consideration is generally treated as satisfying an amount of debt equal to the value of such consideration, with the stock being considered as satisfying the remainder. Thus, if such transaction qualifies for the stock-for-debt exception, the entire amount of COD income realized by the debtor corporation in the transaction generally is excluded from gross income.

a portion of the COD income created by the transfer of its stock in satisfaction of indebtedness by reducing tax attributes.

Effective Date

The proposal would be effective for stock transferred in satisfaction of any indebtedness after June 16, 1993, unless (1) the transfer is in a title 11 or similar case filed on or before June 16, 1993, (2) the transfer occurs on or before December 31, 1993, and the transfer is pursuant to a binding contract in effect on June 16, 1993, or (3) the transfer occurs on or before December 31, 1993, and the taxpayer had filed with the SEC on or before June 16, 1993, a registration statement which proposed a stock for debt exchange with respect to such indebtedness, and which discussed the possible application of the stock-for-debt exception to such exchange.

7. Treatment of passive activity losses and credits and alternative minimum tax credits in certain discharges of indebtedness

Present Law

The discharge of indebtedness generally gives rise to gross income to the debtor taxpayer. Present law provides exceptions to this general rule. Among the exceptions are rules providing that income from the discharge of indebtedness of the taxpayer is excluded from income if the discharge occurs in a title 11 case, the discharge occurs when the taxpayer is insolvent, or in the case of certain farm indebtedness. The amount excluded from income under these exceptions is applied to reduce tax attributes of the taxpayer. The tax attributes reduced (in order) are (1) net operating losses and carryovers, (2) carryovers to or from the year of discharge in determining the general business credit, (3) net capital losses for the year of discharge and capital loss carryovers to the year of discharge, (4) the basis of certain property of the taxpayer, and (5) foreign tax credit carryovers.

Under 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. A similar rule applies with respect to credits from passive activities. Deductions and credits suspended under these rules are carried forward to the next taxable year, and are allowed in full when the taxpayer disposes of his entire interest in the passive activity to an unrelated person. Passive losses and credits are not tax attributes that are reduced under the rule relating to exclusion of discharge of indebtedness income.

If a taxpayer pays alternative minimum tax, the amount of the tax so paid generally is allowed as a credit against the regular tax in future years. This is referred to as the alternative minimum tax credit. In the case of an individual, the alternative minimum tax credit is the amount of the alternative minimum tax paid that is attributable to adjustments relating to timing differences with the regular tax. The alternative minimum tax credit cannot be used to reduce tax below the tentative minimum tax in subsequent years. The alternative minimum tax credit is not a tax attribute that is reduced under the rule relating to exclusion of discharge of indebtedness income.

Description of Proposal

The proposal would add (1) passive activity loss and credit carryovers and (2) alternative minimum tax credits from the taxable year of the discharge to the tax attributes that are reduced in the case of a discharge of indebtedness of the taxpayer that is excludable from income. The amount of the reduction would

generally be one dollar for each dollar excluded, except that the reduction in the case of credits would be 33-1/3 cents for each dollar excluded.

Effective Date

The proposal would apply for taxable years beginning after December 31, 1993.

8. Limitation on section 936 credit

Present Law

Section 936 credit

Certain domestic corporations with business operations in the U.S. possessions (including, for this purpose, Puerto Rico and the U.S. Virgin Islands) may elect the use of the section 936 credit which generally eliminates the U.S. tax on certain income related to their operations in the possessions.[1] Income exempt from U.S. tax under this provision falls into two broad categories: business income, which in order to be exempt must be income treated as foreign source income derived from the active conduct of a trade or business within a U.S. possession or from the sale or exchange of substantially all of the assets that were used in such a trade or business; and investment income, which in order to be exempt must be derived from certain investments in the possessions or in certain Caribbean Basin countries. The investment income exempted under the provision is known as "qualified possession source investment income" (QPSII). For these and other purposes, income derived within a possession is encompassed within the term "foreign source income."

In order to qualify for the section 936 credit, a domestic corporation must satisfy two requirements. Under one requirement, the corporation must be treated as deriving at least 75 percent of its gross income from the active conduct of a trade or business within a possession over a three-year period. Under the other requirement, the corporation must be treated as deriving at least 80 percent of its gross income from sources within a possession during that same three-year period.

Dividends paid by a possession corporation to a U.S. shareholder may qualify for the deduction for dividends received from a domestic corporation (sec. 243). In cases where at least 80 percent of the stock of the possession corporation is owned by a single domestic corporation, the possession corporation's possession source income generally may be distributed without the parent corporation incurring any regular U.S. income tax.

Taxes paid or accrued by possession corporations to foreign countries or possessions on income which is taken into account in determining the section 936 credit are neither

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[1] In contrast to the foreign tax credit, the possessions tax credit is a "tax sparing" credit. That is, the credit is granted whether or not the electing corporation pays income tax to the possession.

deductible nor allowable for purposes of determining the foreign tax credit.

A possession corporation's income, the tax on which may be offset by the section 936 credit, is not included in the alternative minimum taxable income (AMTI) of the possession corporation. Thus, possession corporations generally are exempt not only from the regular income tax but also from the alternative minimum tax (AMT). Moreover, dividends received by a U.S. corporation from a possession corporation generally do not constitute AMTI of the recipient corporation since, as described above, they may be offset by the dividends received deduction.

For purposes of determining a U.S. corporation's adjustment to AMTI based on adjusted current earnings (ACE), a deduction is allowed for certain dividends received. Specifically, a deduction is available (to the extent allowed under section 243 or 245) for any dividend that qualifies for the 100-percent dividends received deduction for regular tax purposes, or that is received from a 20-percent owned corporation (as defined in section 243(c)(2)), but only to the extent that the dividend is attributable to income of the paying corporation which is subject to U.S. income tax <u>determined after the application of section 936</u>. A dividend received by a U.S. corporation from its wholly owned possession corporation subsidiary generally does not qualify for the dividends received deduction, and thus increases the ACE of the recipient, because the income of the possession corporation typically is not taxed by the United States due to the section 936 credit.

For purposes of computing the foreign tax credit, the Code provides that dividends paid by a possession corporation to an affiliated U.S. corporation are characterized as foreign source income. Unless an exception applies, dividends are subject to the separate foreign tax credit limitation for passive income. In computing the AMT foreign tax credit, 75 percent of any withholding or income tax paid to a possession with respect to dividends received from a possession corporation generally is treated as a creditable tax.[2] Moreover for such computation, taxes paid to a possession by a possession corporation are deemed to be such a withholding tax for this purpose to the extent they would be treated as taxes paid by the recipient of the dividend under rules similar to the rules of the indirect foreign tax credit (secs. 78 and 902) if the possession corporation were a foreign corporation.

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[2] The amount of tax allowable for purposes of the credit is limited to 75 percent of possessions tax paid in order to correspond to the portion of a dividend from a possession corporation that would be included in the recipient shareholder's AMTI as a result of the ACE adjustment.

Cover over of excise taxes

U.S. excise taxes generally do not apply within Puerto Rico. However, a special excise tax is imposed on articles which are manufactured in Puerto Rico or the U.S. Virgin Islands and shipped into the United States for sale or consumption. The tax is equal to the Federal excise tax that would have been imposed had the articles been manufactured in the United States. Revenues collected from the tax on articles coming into the United States from Puerto Rico or the Virgin Islands generally are covered over to the respective treasuries of those two possessions. With respect to Federal excise taxes imposed on articles containing distilled spirits that are manufactured in Puerto Rico or the Virgin Islands and shipped into the United States, revenues are covered over to the respective treasuries only if at least 92 percent of the alcoholic content of such articles is attributable to rum. The amount of excise taxes covered over to Puerto Rico and the Virgin Islands with respect to such articles cannot exceed $10.50 per proof gallon even though the present tax rate on such items is $13.50 per proof gallon.

Description of Proposal

In general, the proposal provides that the section 936 credit allowed to a possession corporation for a taxable year against U.S. tax on its business income (i.e., income derived from the active conduct of a possession-based business, or from the sale of assets used in such a business) would be computed as under present law, but would be subject to one of two alternative limitations. The choice of which alternative limitation to apply would be made by the taxpayer.

Under one alternative limitation, the section 936 credit allowed to a possession corporation against U.S. tax on business income for a taxable year would be limited to a fixed percentage of the amount allowable under present law.

Under the other alternative limitation, the credit allowed to a possession corporation for a taxable year against U.S. tax on its business income would be limited by the sum of portions of each of the following items: (1) qualified possession compensation paid by the corporation, (2) depreciation deductions claimed by the corporation with respect to tangible property located in a possession and used there in the corporation's trade or business, and (3) if the corporation has not elected the profit-split method for allocating income from intangible property, possession income taxes paid by the corporation during the taxable year.

The proposal would not limit the present-law section 936 credit against U.S. tax on QPSII.

The proposal would also create a new separate foreign tax credit limitation category for purposes of computing the AMT foreign tax credit. The new category would include the portion of dividends received from a possession corporation for which the dividends received deduction is disallowed, and thus is included in alternative minimum taxable income.

The proposal also would temporarily ease the limitation on the cover over of rum excise taxes to Puerto Rico and the Virgin Islands.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1993.

9. Enhance earnings stripping rules

Present Law

Interest expenses of a U.S. corporate taxpayer are generally deductible, whether or not the interest is paid to a related party and whether or not the interest income is subject to U.S. taxation in the hands of the recipient. In certain cases where interest is paid by a corporation to a related person, and no U.S. tax is imposed on the recipient's interest income, the so-called "earnings stripping rules" in the Code provide for denial of interest deductions by the corporate payor to the extent that the corporation's net interest expenses exceed 50 percent of its adjusted taxable income. The disallowance is limited by, among other things, the amount of tax-exempt interest paid to related persons. The disallowance does not apply to interest on debt with a fixed term which was issued on or before July 10, 1989, or which was issued after that date pursuant to certain written binding contracts in effect on that date.

The Treasury is authorized to provide such regulations as may be appropriate to prevent the avoidance of the purposes of this provision, including regulations that would disallow deductions for interest paid to unrelated creditors in certain cases: for example, certain cases that involve guarantees of the debt by parties related to the debtor. The legislative history accompanying the bill enacting the provision, however, indicates an intent that such regulations not generally subject third-party interest to disallowance whenever a guarantee is given in the ordinary course. The legislative history further indicates an expectation that any such regulations would not apply to debt outstanding prior to notice of the rule if and to the extent that the regulations depart from positions the Service and Treasury might properly take under analogous principles of law that would recharacterize guaranteed debt as equity.

To date, Treasury has promulgated no proposed or final regulations that interpret the application of the earnings stripping rules to third-party debt that is guaranteed by a person related to the debtor.

Description of Proposal

Interest would be subject to disallowance under the earnings stripping rules without regard to whether it is interest on a fixed-term obligation issued before, on, or after July 10, 1989. Interest paid on a loan from an unrelated party generally would be treated under the earnings stripping rules as interest paid to a related person with respect to which no U.S. tax is imposed if no gross-basis U.S. income tax is imposed on the interest (whether or not the interest recipient is subject to net-basis U.S. income tax with respect to that interest), a related person guaranteed the loan, and the related person is either exempt from U.S. Federal income tax or is a foreign person. Exceptions would apply where

the taxpayer controls the guarantor, and in cases, identified by regulation, where the interest on the indebtedness would have been subject to net basis tax if the interest had been paid to the guarantor. Except as provided in regulations, a guarantee would be defined to include any arrangement under which a person directly or indirectly assures, on a conditional or unconditional basis, the payment of another's obligation.

Effective Date

The proposal would apply to any interest paid or accrued in taxable years beginning after December 31, 1993.

C. Foreign Tax Provisions

1. Require current taxation of certain earnings of controlled foreign corporations

Present Law

In general

U.S. persons generally are taxed currently by the United States on their worldwide income. U.S. tax on foreign source income may be reduced by credits for foreign income taxes paid by the U.S. person. Foreign income earned by a foreign corporation, the stock of which is owned in whole or in part by U.S. persons, generally is not taxed by the United States until the foreign corporation repatriates those earnings by payment of a dividend to its U.S. stockholders. If a foreign corporation pays a dividend to a domestic corporation that owns 10 percent or more of the voting stock of the foreign corporation, the domestic corporation may receive credits for foreign income taxes paid by the foreign corporation. This is sometimes known as the "indirect" foreign tax credit.

Controlled foreign corporations

A "U.S. shareholder" of a U.S.-controlled foreign corporation--i.e., a U.S. person that is treated as owning at least 10 percent of the foreign corporation's voting stock--may be taxed by the United States on certain earnings of the controlled foreign corporation that have not been distributed by the foreign corporation to the U.S. shareholder. Such "inclusions" of undistributed controlled foreign corporation earnings are triggered by two different provisions of the controlled foreign corporation rules.

Under one such provision, a U.S. shareholder is taxed currently on its proportionate share of the controlled foreign corporation's "subpart F income" earned during the taxable year. Subpart F income typically is foreign income that is relatively movable from one taxing jurisdiction to another and that is subject to low rates of foreign tax. While subpart F income generally includes dividends received by the controlled foreign corporation, an exception applies to certain dividends from related corporations organized and operating in the same foreign country as the controlled foreign corporation.

The other provision taxing U.S. shareholders on undistributed controlled foreign corporation earnings applies to the controlled foreign corporation's total current or accumulated earnings (other than subpart F income), to the extent of an increase in the amount of those earnings invested by the controlled foreign corporation in certain U.S. property (as defined in Code section 956).

Like the U.S. tax on dividends, the U.S. tax on inclusions of subpart F income and on inclusions based on earnings invested in U.S. property may be reduced by credits for foreign income taxes, including "indirect" credits for taxes paid by the controlled foreign corporation.

Receipt of previously taxed earnings and profits

Earnings and profits of a controlled foreign corporation that have been included in the income of U.S. shareholders before actual repatriation are not taxed again when such earnings are in fact distributed to the U.S. shareholders. A U.S. shareholder is permitted to increase its foreign tax credit limitation in the year of the distribution of previously taxed earnings and profits. The increase equals the excess of the amount by which its foreign tax credit limitation for the year of the income inclusion was increased as a result of that inclusion, over the amount of foreign taxes which were allowable as a credit in that year and which would not have been so allowable but for the income inclusion. The increase in the foreign tax credit limitation may not, however, exceed the amount of the foreign taxes actually paid with respect to the distribution of previously taxed earnings and profits. All such determinations are made separately for each foreign tax credit limitation category.

Passive foreign investment companies

If any foreign corporation (including a controlled foreign corporation) is a "passive foreign investment company" (PFIC), U.S. persons (including 10-percent "U.S. shareholders") that own any stock in the PFIC may be subject to one of two other sets of operating rules that eliminate or reduce the benefits of deferral. A PFIC generally is defined as any foreign corporation if (1) 75 percent or more of its gross income for the taxable year consists of passive income, or (2) 50 percent or more of its assets consist of passive assets, defined as assets that produce, or are held for the production of, passive income.

A U.S. person owning PFIC stock may elect to include currently in gross income its share of the PFIC's total earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received. A nonelecting U.S. person owning PFIC stock pays no current tax on the PFIC's undistributed income. However, when realizing income earned through ownership of PFIC stock (such as certain dividends distributed by the PFIC or capital gains from selling PFIC stock), the nonelecting U.S. person may pay an additional interest charge.

Description of Proposal

Inclusions based on excess passive assets

Require any "U.S. shareholder" of a controlled foreign corporation to include in income the lesser of (a) its pro rata share of the controlled foreign corporation's passive assets that exceed 25 percent of the foreign corporation's total assets, reduced by amounts that were previously included under this provision in the income of the U.S. shareholder (or a predecessor in interest); or (b) its pro rata share of the foreign corporation's total current earnings or earnings accumulated in taxable years beginning after September 30, 1993, excluding amounts of such earnings that were previously included under this provision or section 956 in the income of the U.S. shareholder (or a predecessor in interest). Such lesser amount, however, shall be included only to the extent that it exceeds the foreign corporation's undistributed income that was previously included as subpart F income in the income of the U.S. shareholder (or a predecessor in interest) for a taxable year beginning after September 30, 1993. All amounts under this provision would be determined after the application of section 956 (and income inclusions thereunder) for the taxable year.

The controlled foreign corporation's assets would be measured using an average of adjusted basis (as determined for purposes of calculating earnings and profits), as of the close of each quarter of the taxable year. Adjusted basis would be specially determined in the case of intangible assets, solely for purposes of this measurement. Intangible assets owned by the controlled foreign corporation would be treated as having an aggregate adjusted basis in the amount of the total of research and development expenditures and cost-sharing payments made by the controlled foreign corporation, for qualified research or experimental expenditures (as defined for purposes of Code section 174 and the Treasury regulations thereunder), taking into account payments and expenditures made in the current taxable year and the two most recent preceding taxable years. Intangible assets licensed by the controlled foreign corporation and used in the active conduct of its trade or business would be treated as assets owned by the controlled foreign corporation, and as having aggregate adjusted basis in the amount of three times the total royalty and fee payments made during the taxable year to unrelated persons and related U.S. persons for the license of intangible property. Passive assets would be defined as under the PFIC rules, which themselves are modified under the proposal (see description of modifications below). The PFIC look-through rules would apply.

In addition, the amount of income inclusions on account of a controlled foreign corporation's excess passive assets would be computed by taking into account assets of certain related controlled foreign corporations. Under this rule, the amount of excess passive assets for the related group would be determined

by taking into account the total assets and passive assets of controlled foreign corporations in the group, which may include shareholder foreign corporations as well as subsidiary foreign corporations.

Regulatory authority would be provided under which two or more controlled foreign corporations that have common ownership but are not in the same related group may be treated as if they were within the same related group, if one of the principal purposes for separately organizing, acquiring, or maintaining such multiple corporations was to avoid an inclusion under the excess passive assets proposal.

Property that would be described both as a passive asset under this provision and as U.S. property under section 956 would be treated only as U.S. property under section 956.

Proper adjustments would be made to the measurement of assets and earnings in the case of any foreign corporation that ceases to be U.S.-controlled during the taxable year.

Modification of section 956

Treat earnings invested by a controlled foreign corporation in U.S. property under revised rules that parallel those that would govern the treatment of earnings invested in passive assets in excess of 25 percent of total assets, as described above. Under the revised rules, the amount subject to inclusion by each U.S. shareholder under section 956 would be the lesser of (a) its pro rata share of the amount of U.S. property held by the controlled foreign corporation, reduced by amounts that were previously included under section 956 (as revised or under present law) in the income of the U.S. shareholder (or a predecessor in interest); or (b) its pro rata share of the foreign corporation's total current or accumulated earnings, excluding amounts that were previously included under the excess passive assets provision or under section 956 (as revised or under present law) in the income of the U.S. shareholder (or a predecessor in interest). Such lesser amount, however, shall be included only (as under present law in the case of an actual distribution) to the extent that it exceeds the foreign corporation's undistributed income that was previously included as subpart F income in the income of the U.S. shareholder (or a predecessor in interest).

The controlled foreign corporation's assets would be measured using an average of adjusted basis (as determined for purposes of calculating earnings and profits), as of the close of each quarter of the taxable year, less any liability to which the property is subject (as under present law).

Same-country dividend rule

Limit the application of the subpart F same-country exception in the case of certain dividends received by controlled foreign corporations. Amounts distributed with respect to stock owned by the controlled foreign corporation would not qualify for the same-country exception to the extent that the distributed earnings and profits were accumulated by the distributing corporation during periods when the controlled foreign corporation did not hold the stock.

Effect on foreign tax credit limitation of distributions of previously taxed earnings

Receipt of previously taxed income by a U.S. shareholder of one or more controlled foreign corporations would increase the U.S. shareholder's foreign tax credit limitation to the extent of the aggregate amount in a single "excess limitation account" maintained by that U.S. shareholder for each of its separate foreign tax credit limitation categories. That account would reflect the cumulative amount by which the taxpayer's foreign tax credit limitation had been increased on account of subpart F income inclusions (in excess of the foreign taxes allowed as a credit on account of such inclusions) in taxable years beginning after September 30, 1993, less the total amount by which the account was used to increase the U.S. shareholder's foreign tax credit limitation upon the actual distribution of such previously taxed earnings and profits.

Measurement of assets, passive income, and distributions for PFIC purposes in the case of U.S. shareholders of controlled foreign corporations

In testing a controlled foreign corporation for PFIC status with respect to its "U.S. shareholders," measure assets by adjusted basis as determined for purposes of calculating earnings and profits, with no option to use fair market value.

In addition, the proposal would exclude from the definition of passive income under the PFIC rules all income derived in the active conduct of a securities business by certain corporations registered in the United States as brokers or dealers in securities, and, to the extent provided in Treasury regulations, by any other corporation engaged in the active conduct of a business as a broker or dealer in securities. As with the asset valuation rule above, this exclusion would apply only to a controlled foreign corporation, and only for purposes of the treatment of its U.S. shareholders.

Inclusions of income on account of investments of earnings of a controlled foreign corporation in U.S. property, or ownership of excess passive assets, would be treated as distributions for purposes of computing the interest charge on

excess distributions to the U.S. shareholders of PFICs that are controlled foreign corporations.

Treatment of certain leased assets for PFIC purposes

In testing any foreign corporation for PFIC status, treat certain leased property as assets held by the foreign corporation to the extent of the unamortized portion of the present value of payments under the lease.

Effective Date

The proposals generally would be effective for taxable years of foreign corporations beginning after September 30, 1993, and for taxable years of domestic shareholders in which or with which such taxable years end.

The proposal modifying the rules for increasing foreign tax credit limitation upon distributions of previously taxed income would be effective for actual distributions of earnings that were included under subpart F in taxable years of U.S. shareholders beginning after September 30, 1993.

2. Allocation of research expense

Present Law

In order that the foreign tax credit will offset only the U.S. tax on the taxpayer's foreign source taxable income, a limitation formula is prescribed in the Code. To compute the limitations, it is necessary to divide the taxable income of a U.S. person into U.S. source taxable income, foreign source taxable income in each applicable separate limitation category, and foreign source taxable income in the general foreign tax credit limitation category.

Foreign source taxable income in any limitation category equals foreign source gross income in that category less the expenses, losses and other deductions properly apportioned or allocated to that income. A Treasury regulation issued in 1977 describes methods for allocating expenses between U.S. and foreign source income, including rules for the allocation of research expenses. Since 1981, however, the research expense allocation regulation has been subject to a series of statutory temporary suspensions and modifications. The most recent temporary statutory provision (set forth in Code section 864(f)) was applicable generally for the first six months of the first taxable year beginning after August 1, 1991. For this purpose, total research expenses for the year were deemed to be incurred evenly throughout the year.

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

The Treasury has announced that during what would ordinarily be an 18-month period following the six-month period referred to above--that is, the last six months of the taxpayer's first taxable year beginning after August 1, 1991 and the immediately succeeding taxable year--taxpayers may continue to allocate research expenses in accordance with the method set forth in Code section 864(f). In granting the transitional period, Treasury stated that the transitional method was not intended to suggest any particular views about the proper allocation and apportionment of research expenses. Rather, Treasury stated, the transition method was intended solely to provide taxpayers with transitional relief and to minimize audit controversy and

facilitate business planning during the conduct of the regulatory review.

Description of Proposal

The proposal would temporarily extend the research allocation rules set forth in Code section 864(f), except that the portion of research expense automatically allocated and apportioned to income sourced in the place of performance of the research would be 50 percent, rather than 64 percent. Thus, for research expense other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source, 50 percent of U.S.-incurred research expense would be allocated and apportioned to U.S. source income, and 50 percent of foreign-incurred research expense would be allocated and apportioned to foreign source income. The remaining research expense would be allocated and apportioned either on the basis of sales or gross income, but subject to the condition that if income-based apportionment were used, the amount apportioned to foreign source income would be no less than 30 percent of the amount that would have been apportioned to foreign source income had the sales method been used.

Regulatory authority would be provided for the implementation of certain adjustments regarding section 936 companies. In addition, the Treasury would be authorized to prescribe such regulations as may be appropriate to carry out the purposes of this provision, including regulations relating to the determination of whether research activities are conducted inside or outside the United States and making such adjustments as may be appropriate in the case of cost sharing arrangements and contract research.

Effective Date

The proposal would apply to the taxable year that commences immediately following the taxpayer's last taxable year to which Rev. Proc. 92-56 applies, or would have applied had the taxpayer been in existence and elected the benefits of that Revenue Procedure.

3. Eliminate working capital exception for foreign oil and gas and shipping income

Present Law

Foreign tax credit limitations in general

Foreign tax credit limitations are computed separately for certain categories of foreign source income, including passive income. Passive income generally includes income which is of a kind which would be foreign personal holding company income as defined under Code section 954(c) (e.g., interest and dividends) and typically is not subject to high levels of foreign tax. The separate limitation for passive income generally prevents the cross-crediting of high foreign taxes on income which falls in the general basket against the residual U.S. tax on passive income.

The separate foreign tax credit limitation for passive income was enacted in 1986 and replaced the prior law separate foreign tax credit limitation for passive interest income. Prior law excluded from the passive interest separate limitation category interest derived from any transaction which is directly related to the active conduct by the taxpayer of a trade or business in a foreign country. Regulations under prior law expressly treated certain types of interest on working capital as interest derived from a transaction which is directly related to the active conduct of a trade or business. No such general working capital exception exists under the passive income definition as established in 1986. As a result of the interaction of the Code and Treasury regulations originally developed prior to 1987, however, the working capital exception has been retained for the oil and gas and shipping industries.

Special limitation on credits for foreign extraction taxes and taxes on foreign oil related income

In addition to the foreign tax credit limitations that apply to all foreign tax credits, a special limitation is placed on foreign income taxes on foreign oil and gas extraction income (FOGEI). Under this special limitation, amounts claimed as taxes paid on FOGEI of a U.S. corporation qualify as creditable taxes (if they otherwise so qualify) only to the extent they do not exceed the product of the highest marginal U.S. tax rate on corporations (presently 34 percent) multiplied by such extraction income. Foreign taxes paid in excess of that amount on such income are, in general, neither creditable nor deductible (unless a credit carryover provision applies).

A similar special limitation may apply to foreign taxes paid on foreign oil related income (FORI) in certain cases where that type of income is subjected to a materially greater

level of tax by a foreign jurisdiction than non oil and gas income generally would be. Under this limitation, a portion of the foreign taxes on FORI may be deductible, but not creditable.

Under regulations, the definitions of FOGEI and FORI include interest on bank deposits or on any other temporary investment which is not in excess of funds reasonably necessary to meet the working capital requirements and the specifically anticipated business needs of a taxpayer engaged in extraction or oil related activities. Thus, under current regulations, FOGEI and FORI include what generally would be considered as passive income for foreign tax credit limitation purposes.

Description of Proposal

In general

The proposal would prevent the cross-crediting of foreign taxes on FOGEI, FORI, and shipping income by placing certain passive income related to oil and gas and shipping operations in the passive category for foreign tax credit limitation purposes. In addition, the proposal would exclude certain passive income related to foreign oil and gas extraction or other foreign oil related activities from the computation of the FOGEI and FORI foreign tax credit limitations.

Foreign tax credit separate limitations

With respect to the separate foreign tax credit limitation for passive income, the proposal would eliminate the present-law exclusion of FOGEI from the definition of passive income. Thus, if a taxpayer has gross income that falls within the definition of passive income under section 904, and also satisfies the definition of FOGEI under section 907, the income would be treated as passive income in determining the taxpayer's foreign tax credit.

In addition, the proposal would amend the present-law rule applicable to income which by definition qualifies both as foreign personal holding company income under section 954(c) and as foreign base company oil related income under section 954(g). The proposal provides that such income would be treated as foreign personal holding company income. As such, the income generally would be passive income for foreign tax credit purposes.

Likewise, the proposal would specify that dividend or interest income that by definition qualifies as both foreign personal holding company income and foreign base company shipping income would be treated as foreign personal holding company income. Thus, for foreign tax credit purposes, the income would fall in the passive basket rather than in the separate basket for shipping income.

Special FOGEI and FORI limitations

The proposal would provide that the term "foreign oil and gas extraction income" would not include any dividend or interest income which is passive income as defined for foreign tax credit limitation purposes. Since, as discussed above, the proposal would treat gross interest income on working capital related to foreign oil and gas extraction activities, for example, as passive income, such income would not be considered FOGEI for purposes of computing the special limitation for foreign taxes paid on FOGEI.

In addition, the proposal would specify that the term "foreign oil related income" would not include any dividend or interest income which is passive income as defined under the foreign tax credit provisions. As a result, for example, gross interest income on working capital related to activities which generate foreign oil related income would not be treated as FORI for purposes of computing the special limitation for foreign taxes paid on FORI.

Effective Date

The proposal would apply to income earned in taxable years beginning after December 31, 1992.

4. Transfer pricing initiative

Present Law

A "substantial" valuation misstatement may result in a penalty of 20 percent of the understatement of tax attributable to the substantial valuation misstatement (sec. 6662(a) and (b)(2)). The penalty for a "gross" valuation misstatement is 40 percent of the tax understatement (sec. 6662(h)). No valuation misstatement penalty is imposed if it is shown that there was reasonable cause for the underpayment and that the taxpayer acted in good faith (see sec. 6664(c)).

There is a substantial valuation misstatement if, among other things, the net section 482 transfer price adjustment for the taxable year exceeds $10 million. The analogous "gross valuation misstatement" involves a net section 482 transfer price adjustment of $20 million. The net section 482 transfer price adjustment is the net increase in taxable income for a taxable year resulting from adjustments under section 482 in the price for any property or services (or use of property). However, a net increase in taxable income attributable to a price redetermination is disregarded, for this purpose, if it is shown that there was a reasonable cause for the taxpayer's determination of the price, and that the taxpayer acted in good faith with respect to the price.

Description of Proposal

The threshold amount of net section 482 transfer price adjustment that generally would trigger a substantial valuation misstatement penalty would be lowered to $5,000,000. In addition, the term substantial valuation misstatement would be expanded to include a case where the net section 482 transfer price adjustment for the taxable year exceeds 10 percent of the taxpayer's gross receipts. The term gross valuation misstatement would include a case where the net section 482 transfer price adjustment exceeds 20 percent of gross receipts.

In measuring the amount of a taxpayer's net section 482 transfer price adjustment, a net increase in taxable income attributable to a price redetermination would be disregarded only if the taxpayer satisfies certain statutory requirements.

The taxpayer would meet the requirements if it established that each of three criteria were met. First, the taxpayer would have to establish that the price it used was determined under a pricing method specified in the section 482 regulations. Second, the taxpayer would have to establish that it applied the method reasonably. (In order for the application of the method to have been reasonable, it is intended that any procedural or other requirements imposed under the regulations must have been observed. For example, if certain adjustments required under a particular method were not made, the application of that method would not be reasonable.) Third, the taxpayer would have to establish that it

had documentation, in existence as of the time of filing its original return, setting forth the reasonable determination of the price as described above, which documentation the taxpayer provides to the IRS within 30 days of a request for it.

Alternatively, the taxpayer would meet the requirements if it established that none of the methods specified in the section 482 regulations was likely to result in a price that would clearly reflect income, that it used another method which was likely to result in such a price, and that it had documentation, in existence as of the time of filing its original return, setting forth the determination of the price and establishing the foregoing requirements, which documentation the taxpayer provides to the IRS within 30 days of a request for it.

It is intended that the application of any method would not be considered reasonable if the taxpayer became aware prior to filing its tax return that such application more likely than not did not lead to an arm's length result.

In the case of a valuation misstatement due to a net section 482 transfer price adjustment, no penalty would be excused for reasonable cause and good faith unless the above requirements were met.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1993.

5. Deny portfolio interest exemption for contingent interest

Present Law

Deductibility of interest

As a general rule, a deduction is allowed for all interest paid or accrued on indebtedness. Whether a financial instrument is treated as debt for Federal income tax purposes depends on the facts of the particular case. Under existing law, an instrument may qualify as debt even if it provides the holder with significant equity participation rights. For example, the IRS has ruled that in certain cases, contingent interest paid on a shared appreciation mortgage loan used to finance the purchase of a personal residence may be deductible by a cash basis payor.[1] As another example, contingent interest based on a share of the borrower's profits has been determined to be deductible in certain cases.[2]

Interest received by foreign persons

The Code provides that U.S. source interest income earned by a nonresident alien individual or a foreign corporation that is not effectively connected with the conduct of a U.S. trade or business generally is subject to a gross-basis 30-percent withholding tax. A significant statutory exemption from that tax applies to so-called "portfolio interest" received by foreign persons.

Portfolio interest generally is defined as any U.S. source interest (including original issue discount) that is not effectively connected with the conduct of a trade or business and (1) is paid on an obligation that satisfies certain registration requirements or specified exceptions thereto, and (2) is not received by a 10-percent owner of the issuer of the obligation, taking into account shares owned by attribution.[3]

Foreign investment in U.S. real property--shared appreciation debt

A foreign person's gain on the disposition of a U.S. real property interest (USRPI) is treated as income that is effectively connected with the conduct of a U.S. trade or business, and thus is subject to net-basis tax at ordinary U.S. income tax rates pursuant

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[1] Rev. Rul. 83-51, 1983-1 C.B. 48.

[2] See, e.g., Dorzback v. Collison, 195 F.2d 69 (3d Cir. 1952).

[3] Certain additional exceptions to this general rule apply only in the case of a corporate recipient of interest. In such a case, the term portfolio interest generally excludes (1) interest received by a bank on a loan extended in the ordinary course of its business (except in the case of interest paid on an obligation of the United States), and (2) interest received by a controlled foreign corporation from a related person.

to the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). USRPIs include interests (other than solely as a creditor) in (1) real property, and (2) domestic corporations that are U.S. real property holding corporations (USRPHCs).

Whether a financial instrument is considered debt under any provisions of the Code is not determinative of whether it constitutes an "interest solely as a creditor" for purposes of FIRPTA. Regulations provide that an interest in real property other than an interest solely as a creditor includes any right to share in the appreciation in the value of, or in the gross or net proceeds or profits generated by, the real property. Similarly, an interest in an entity (such as a USRPHC) other than an interest solely as a creditor includes any right to share in the appreciation in the value of an interest in, or the assets of, the entity, or a right to share in the gross or net proceeds of profits derived by, the entity.

Regulations further provide that amounts otherwise treated for tax purposes as principal and interest payments on debt obligations of all kinds (including obligations that are interests other than solely as a creditor) do not give rise to gain or loss that is subject to U.S. tax under FIRPTA.[4] Thus, a foreign owner of a note that pays interest contingent on appreciation in U.S. real property incurs U.S. income tax if he disposes of the note, but may not incur U.S. income tax if he holds the note and receives interest payments under its terms.

Description of Proposal

The proposal would make the portfolio interest exemption inapplicable to certain contingent interest income received by foreign persons. In the case of an instrument on which a foreign holder earns both contingent and non-contingent interest, denial of the portfolio interest exemption would apply only to the portion of the interest which is contingent interest.

Under the proposal, contingent interest would include interest determined by reference to any of the following attributes of the debtor or any related person: receipts, sales, or other cash flow; income or profits; or changes in the value of property. The proposal would not treat interest as contingent merely because its payment can be impaired by a default on the debt obligation by the borrower. In addition, contingent interest would include interest determined by reference to any dividend, partnership distribution, or similar payment made by the debtor or a related person.

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[4] Treas. Reg. sec. 1.897-1(h). FIRPTA applies in the case of a "disposition" of a USRPI. Treasury Reg. sec. 1.897-1(h) generally defines a disposition as a transaction that gives rise to gain under section 1001 of the Code. Section 1001 does not apply to interest received on indebtedness.

The proposal would provide a number of exceptions to the general definition of contingent interest as detailed above. Under one such exception, interest would not be considered contingent solely because the timing of the interest or any related principal payment is subject to a contingency. In addition, portfolio interest treatment would not be denied under the proposal solely because the interest is paid with respect to nonrecourse or limited recourse indebtedness.

Interest also would not be denied portfolio treatment under the proposal if all or substantially all of it is determined by reference to certain other amounts of interest that is not described as contingent above (or by reference to the principal amount of indebtedness on which such other interest is paid). In determining whether all or substantially all of an amount of interest payable on a debt obligation is computed by reference to another amount of interest that is not contingent interest, other factors that affect the amount of interest payable on the debt obligation, but which are not contingencies as contemplated by the proposal, would not be taken into account.

Another of the proposal's exceptions would provide that interest would not be denied portfolio treatment solely because the debtor or a related person enters into a hedging transaction to reduce the risk of interest rate or currency fluctuations with respect to such interest. Interest also would not be denied portfolio treatment under the proposal if it is determined by reference to changes in the value of (or any index of the value of) actively traded property other than a USRPI. For this purpose, the term "property" includes stock, and the term "actively traded" has the meaning given to that term under section 1092(d) of the Code. In general, portfolio treatment also would not be denied if the interest is determined by reference to the yield (or any index of the yield) on such actively traded property. However, this exception for interest contingent on the yield of actively traded property would not apply if the property is a debt instrument that itself pays contingent interest as described above, or the actively traded property is stock or other property that represents a beneficial interest in the debtor or a related person.

Application of the proposal may be extended to any type of contingent interest not specifically described in the proposal, if identified by the Treasury Secretary in regulations. The Secretary would be granted authority under the proposal to issue such regulations to supplement the statutory description of contingent interest in order to address cases where a denial of the portfolio interest exemption would be necessary or appropriate to prevent avoidance of U.S. income tax. The proposal additionally provides that the Secretary may by regulation exempt any type of interest from denial, under the proposal, of portfolio treatment.

The proposal would not override existing treaties that reduce or eliminate U.S. withholding tax on interest paid to foreign persons.

Effective Date

The proposal would apply to interest received after December 31, 1993. It would not apply, however, to any interest paid or accrued with respect to any indebtedness with a fixed term that was issued on or before April 7, 1993, or was issued after such date pursuant to a written binding contract in effect on such date and at all times thereafter before such indebtedness was issued.

6. Regulatory authority to address multiple-party financing arrangements

Present Law

The tax treatment of a transaction may depend on the identity of the parties to the transaction. For example, a loan by a controlled foreign corporation to a related U.S. borrower is treated as an investment in U.S. property under Code section 956, and as such, may result in an inclusion of income to U.S. shareholders of the foreign corporation. On the other hand, an income inclusion to the U.S. shareholders of the foreign corporation would not have resulted had the loan been made by the same foreign corporation to an unrelated foreign borrower.

Under the Code, payments of interest by U.S. persons to related foreign persons may be subject to 30-percent gross-basis withholding tax. On the other hand, no such tax applies to payments by U.S. persons to unrelated foreign persons of so-called portfolio interest. Under treaties, payments of interest by U.S. persons to related foreign persons who are resident in the treaty country may be subject to little or no U.S. gross-basis tax. By contrast, if the related recipient of interest is resident in a country with respect to which no U.S. income tax treaty is in force, the 30-percent gross-basis tax would be imposed.

Courts have stated that the incidence of taxation depends upon the substance of a transaction as a whole.[1] In certain cases, courts have recharacterized transactions in order to impose tax consistent with this principle. For example, where three parties have engaged in a chain of transactions, the courts have at times ignored the "middle" party as a mere "conduit," and imposed tax as if a single transaction had been carried out between the parties at the ends of the chain.

In Aiken Industries, Inc. v. Commissioner,[2] the Tax Court recharacterized an interest payment by a U.S. person on its note held by a related treaty-country resident, which in turn had a precisely matching obligation to a related non-treaty-country resident, as a payment directly by the U.S. person to the non-treaty-country resident. The transaction in its recharacterized form resulted in a loss of the treaty protection that would otherwise have applied on the payment of interest by the U.S. person to the treaty-country resident, and thus subjected the interest payment to 30-percent U.S. tax.

The IRS has taken the position that it will apply a similar result in cases where the back-to-back related party debt

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[1] See, e.g., Commissioner v. Court Holding Co., 324 U.S. 331 (1945).

[2] 56 T.C. 925 (1971), acq. on another issue, 1972-2 C.B. 1.

obligations are less closely matched than those in Aiken Industries, so long as the intermediary entity does not obtain complete dominion and control over the interest payments.[3] The IRS has taken an analogous position where an unrelated financial intermediary is interposed between the two related parties as lender to one and borrower from the other, as long as the intermediary would not have made or maintained the loan on the same terms without the corresponding borrowing.[4] In a recent technical advice memorandum, the IRS has taken the position that interest payments by a U.S. company to a related, treaty-protected financial intermediary may be treated as payments by the U.S. company directly to the foreign parent of the financial intermediary even though the matching payments from the intermediary to the parent are not interest payments, but rather are dividends.[5]

Description of Proposal

The Secretary would be authorized to issue regulations that set forth rules for recharacterizing any multiple-party financing transaction as a transaction directly among any two or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by the Internal Revenue Code.

Effective Date

The proposal would be effective on date of enactment. No inference would be intended as to positions taken by the Secretary under present law.

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[3] Rev. Rul. 84-152, 1984-2 C.B. 381; Rev. Rul. 84-153, 1984-2 C.B. 383.

[4] Rev. Rul. 87-89, 1987-2 C.B. 195.

[5] Tech. Adv. Mem. 9133004 (May 3, 1991).

7. Amend certain provisions relating to the export of certain unprocessed timber

Present Law

In general

The Internal Revenue Code contains certain provisions, applicable to U.S. persons and to foreign corporations owned by U.S. persons, that are designed to encourage the export of goods, including timber, from the United States.

Rules for sourcing income

Subject to significant exceptions, income from the sale of personal property generally is sourced on the basis of the residence of the seller. One set of exceptions apply to sales of inventory property. Income derived from the purchase of inventory property within the United States and its sale outside the United States constitutes foreign source income. Similarly, income derived from the purchase of inventory property outside the United States and its sale within the United States constitutes domestic source income. Income attributable to the marketing of inventory property by U.S. residents in other cases may also have its source determined to be the place of sale. For this purpose, the place of sale generally is the place where title to the property passes to the purchaser (the "title passage" rule).

Income derived from the manufacture of products in the United States and their sale elsewhere is treated as having a divided source. Under Treasury regulations, 50 percent of such income generally is attributed to the place of production (in this case, the United States), and 50 percent of the income is attributed to marketing activities and is sourced on the basis of the place of sale (determined under the title passage rule). Under certain circumstances, the division of the income between production and marketing activities must be made on the basis of an independent factory or production price, rather than on a 50-50 basis, where a taxpayer sells part of its output to wholly independent distributors or other selling concerns in such a way as to establish fairly the independent factory or production price unaffected by considerations of tax liability (Treas. Reg. sec. 1.863-3(b)(2), Example (1); Notice 89-10, 1989-4 I.R.B. 10).

Income earned by foreign corporations

The United States exerts jurisdiction to tax all income, whether derived in the United States or elsewhere, of U.S. citizens, residents, and corporations. By contrast, the United States taxes nonresident aliens and foreign corporations only on income with a sufficient nexus to the United States. In the case of income earned by a U.S.-owned foreign corporation,

generally no U.S. tax is imposed until that income is distributed to the U.S. shareholders as a dividend.

When a U.S.-controlled foreign corporation earns so-called "subpart F income," the United States generally taxes the corporation's 10-percent U.S. shareholders currently on their pro-rata share of that income regardless of whether the income is actually distributed currently to the shareholders. Included among the types of income deemed distributed (generally referred to as "subpart F income") is foreign base company sales income.

Certain subpart F income derived by a controlled foreign corporation that is an export trade corporation (ETC) from certain export activities is exempt from current taxation. Under this exemption, the subpart F income of an ETC is reduced by certain amounts that constitute export trade income (as defined in section 971). No foreign corporation may qualify as an ETC unless it has so qualified generally since 1971.

Foreign sales corporations

A portion of the income of an eligible foreign sales corporation (FSC) that is generated from export property is exempt from Federal income tax. If the income earned by the FSC is determined under special administrative pricing rules, then the exempt foreign trade income generally is 15/23 of the foreign trade income the FSC derives from the transaction. In addition, a domestic corporation is allowed a 100-percent dividends-received deduction for dividends distributed from the FSC out of earnings attributable to certain foreign trade income. Thus, there generally is no corporate level tax imposed on a portion of the income from exports of a FSC.

Foreign trade income is defined as the gross income of a FSC attributable to foreign trading gross receipts. Foreign trade income includes both the profits earned by the FSC itself from exports and commissions earned by the FSC from products exported by others and services related thereto. In general, the term foreign trading gross receipts means the gross receipts of a FSC which are attributable to the export of certain goods and services. Foreign trading gross receipts are the gross receipts of the FSC that are attributable to the following types of transactions: the sale of export property, the lease or rental of export property, services related and subsidiary to the sale or lease of export property, engineering and architectural services, and export management services.

Export property, for purposes of the FSC rules, is defined as property that is (1) manufactured, produced, grown, or extracted in the United States by a person other than a FSC, (2) held primarily for sale, lease, or rental, in the ordinary conduct of a trade or business by, or to, a FSC, for direct use, consumption, or disposition outside the United States, and

(3) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States.

Domestic International Sales Corporations

Prior law provided for a system of tax deferral for corporations known as Domestic International Sales Corporations, or "DISCs," and their shareholders. Under this system, the profits of a DISC were not taxed to the DISC but were taxed to the shareholders of the DISC when distributed or deemed distributed to them. Each year, a DISC was deemed to have distributed a portion of its income, thereby subjecting that income to current taxation in its shareholders' hands. Federal income tax could generally be deferred on the remaining portion of the DISC's taxable income until the income was actually distributed to the shareholders.

Under current law, a DISC is permitted to continue to defer income attributable to $10 million or less of qualified export receipts. However, unlike the prior-law DISC rules, an interest charge is imposed on the shareholders of the DISC. The amount of the interest is based on the tax otherwise due on the deferred income computed as if the income were distributed. Taxable income of the DISC attributable to qualified export receipts that exceed $10 million is deemed distributed to the DISC's shareholders.

To qualify for DISC treatment, at least 95 percent of a domestic corporation's gross receipts must consist of qualified export receipts. In general, qualified export receipts are receipts, including commission receipts, derived from the sale or lease for use outside the United States of export property, or from the furnishing of services related or subsidiary to the sale or lease of export property. Export property must be manufactured, produced, grown, or extracted in the United States.

Description of Proposal

The proposal would amend certain provisions of the Internal Revenue Code as they apply to exporters of unprocessed timber which is a softwood. For this purpose, the term "unprocessed timber" means any log, cant, or similar form of timber.

The proposal would exclude from the definition of "export property" for purposes of the FSC rules any unprocessed timber which is a softwood. Similarly, the proposal would exclude from the definition of "export property" for purposes of the DISC rules any unprocessed timber which is a softwood.

The proposal also would amend the sales source rules as they apply to inventory property. In this case, the proposal

provides that any income from the sale of any unprocessed timber which is a softwood and which was cut from an area located in the United States would be domestic source income.

Finally, the proposal would treat as subpart F foreign base company sales income any income derived by a controlled foreign corporation in connection with the sale of any unprocessed timber which is a softwood and was cut from an area located in the United States. In addition, the proposal would treat as subpart F foreign base company sales income any income derived by a controlled foreign corporation from the milling of any such timber outside the United States. Any income treated as subpart F income under the proposal that is earned by an export trade corporation would not be subject to reduction by the export trade income of the corporation.

Effective Date

The proposal would be effective for transactions occurring after date of enactment of the proposal.

D. Transportation Fuels Tax Provisions

1. Impose transportation fuels tax and adopt diesel fuel compliance initiative

Present Law

Several separate Federal excise taxes are imposed on specified transportation fuels. Taxable fuels include motor fuels (gasoline, diesel fuel and special motor fuels[1]) used for highway transportation; gasoline used in motorboats; diesel fuel used in trains; fuels used in inland waterways transportation; and, aviation fuel (gasoline and jet fuel) used in most aviation.

Revenues from most of these excise taxes are deposited in various trust funds to finance specific Federal public works and environmental programs. The set of fuels subject to each tax generally reflects the purposes of the trust fund to which the revenues are dedicated. In addition to the dedicated excise taxes, a general deficit reduction tax (in effect through September 30, 1995) is imposed on highway motor fuels, motorboat gasoline and special motor fuels, and train diesel fuel.[2] Revenues from this deficit reduction tax are retained in the General Fund of the Treasury.

One of the dedicated excise taxes is a 0.1 cent per gallon tax (0.05 cent per gallon for qualified ethanol and methanol fuels) imposed on all of the fuels listed above, except liquefied petroleum gas used as a motor fuel. This tax is deposited into the Leaking Underground Storage Tank ("LUST") Trust Fund, which is used to fund cleanup costs associated with leaking underground storage tanks containing petroleum products.

Certain fuel uses are exempt from the LUST excise tax. Exempt uses include No. 2 residual fuel oil (diesel fuel) used as heating oil; gasoline and diesel fuel used on farms for farming purposes; off-highway business uses of fuel (for example, fuel used to operate pumps, generators, compressors, forklift trucks, or bulldozers, or fuel used in vessels used by fisheries or whaling businesses); fuels used by State and local governments; fuels used by nonprofit educational organizations; exported fuels, including fuels used in international aviation and international shipping; fuels used in helicopters used for natural resource exploration or development, timber operations, or emergency medical services;

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[1] Special motor fuels include benzol, benzene, naphtha, liquified petroleum gas, casing head and natural gasoline, and any other liquid (other than kerosene, gas oil, fuel, or gasoline) sold for use in motor vehicles or motorboats.

[2] See Item I.D.2., below, for proposed extension and transfer of the 2.5-cents-per-gallon tax rate.

fuels used by certain aircraft museums; and fuel for military ships and aircraft.

The gasoline excise tax (including the LUST rate on gasoline) is collected when the fuel leaves terminal storage facilities (i.e., at the terminal rack). The diesel fuel excise tax is collected on the wholesale sale of that fuel.

Description of Proposal

Transportation fuels tax

The proposal would impose an additional Federal excise tax of 4.3 cents per gallon on all transportation fuels currently subject to the LUST excise tax (i.e., highway, rail, aviation, and inland waterway fuels), on liquefied petroleum gases currently taxable as special motor fuels, and on diesel fuel used in noncommercial motorboats.

The tax would be collected in the same manner as the existing excise taxes on these fuels (although, as described below, the proposal also would change the point of collection for the present-law diesel fuel excise tax).

Fuel uses that are exempt from the LUST tax would be exempt from the proposed tax. The committee report will include language regarding the treatment of ethanol, methanol, and their derivative ethers in conference.

Diesel fuel compliance

The proposal would adopt a diesel fuel compliance initiative providing that the present-law diesel fuel tax would be collected at the terminal rack generally using the same rules as the highway gasoline tax. Fuel sold for exempt uses could be sold without payment of tax if the fuel were indelibly dyed (blue to comply with the Clean Air Act or another color of choice).

As under present law, refunds would be allowed to persons using tax-paid fuels in exempt uses. In addition, registered dealers selling tax-paid, undyed diesel fuel to farmers and State and local governments would claim refunds on behalf of those customers.

The tax deposit rules for diesel fuel would be conformed to the rules currently applicable to gasoline (because, under the proposal, the two taxes would be collected at the same point and generally from the same persons).

Disposition of revenues

Revenues from the new transportation fuels excise tax would be retained in the General Fund of the Treasury.

Effective Date

The transportation fuels tax provisions would be effective on October 1, 1993, with appropriate floor stocks taxes being imposed on that date.

The diesel fuel compliance provisions would be effective on January 1, 1994.

2. Extend the current 2.5-cents-per-gallon motor fuels excise tax rate; Transfer revenues to the Highway Trust Fund

Present Law

The Federal motor fuels excise taxes generally are imposed on motor fuels (gasoline, special motor fuels, and diesel fuel) used for highway transportation, gasoline and special motor fuels used in motorboats, and diesel fuel used in trains. Off-highway business uses generally are exempt from motor fuels taxes, as are sales for export, for the exclusive use of State and local governments and nonprofit educational organizations, and for farming uses.

The rate of tax on motor fuels is 14.1 cents per gallon on gasoline and special motor fuels and 20.1 cents per gallon on diesel fuel; these rates include a "deficit reduction rate" (General Fund rate) of 2.5 cents per gallon and a Leaking Underground Storage Tank ("LUST") rate of 0.1 cent per gallon. Diesel used in trains is subject only to the 2.5-cents deficit reduction rate and to the 0.1-cent LUST rate (not to the full 20.1 cents per gallon rate). The deficit reduction rate does not apply after September 30, 1995. Revenues from the deficit reduction rate are retained in the General Fund, while the balance of the highway motor fuels tax revenues are transferred to the Highway Trust Fund through September 30, 1999. Revenues from the 0.1-cent-per-gallon LUST tax rate are transferred to the LUST Trust Fund through December 31, 1995.

Currently, 1.5 cents per gallon of the Highway Trust Fund motor fuels tax is credited to the Mass Transit Account in the Highway Trust Fund.

Description of Proposal

The proposal would extend the additional 2.5-cents-per-gallon motor fuels tax rate from October 1, 1995, through September 30, 1999. The revenues from this rate generally would be transferred into the Highway Trust Fund, with revenues equivalent to 2 cents per gallon credited to the Highway Account and 0.5 cent per gallon to the Mass Transit Account. However, revenues from the 2.5-cents-per-gallon tax on diesel used in trains would be retained in the General Fund as would be revenues from 2.5 cents per gallon of the tax on motorboat, small-engine, and nonhighway recreational fuels. The proposal would retain present-law motor fuels tax exemptions.

Effective Date

The extension of the 2.5-cents-per-gallon rate would apply after September 30, 1995.

E. Compliance Provisions

1. Reporting rule for service payments to corporations

Present Law

A person engaged in a trade or business who makes payments during the calendar year of $600 or more to a person for services performed must file an information return with the Internal Revenue Service ("IRS") reporting the amount of such payments, as well as the name, address and taxpayer identification number of the person to whom such payments were made. A similar statement must also be furnished to the person to whom such payments were made. Treasury regulations generally provide, however, that payments to corporations (including payments for services) need not be reported (Treas. Reg. sec. 1.6041-3(c); Prop. Treas. Reg. sec. 1.6041A-1(d)(2)).[1]

Description of Proposal

Under the proposal, payments for services purchased in the course of the payor's trade or business would not be exempt from the information reporting requirements merely because the payments are made to a corporation. The IRS could continue to exempt from information reporting certain types of payments and certain types of corporate payees where the risk of noncompliance is minimal. IRS should implement this provision so as to minimize the burdens on businesses that are fully complying with the law, while at the same time increasing compliance by businesses that are not fully complying. IRS should, for example, rapidly implement measures to reduce the noncompliance that is occurring under present law which is attributable to businesses that claim to be incorporated but in fact are not.

Effective Date

The proposal would apply to payments for services made by a payor after December 31, 1993.

2. Raise standard for accuracy-related and preparer penalties

Present Law

A 20-percent penalty is imposed on any portion of an underpayment of tax that is attributable either to a substantial understatement of income tax on a return, or to negligence or disregard of rules or regulations (sec. 6662).

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[1] In general, information returns are required regarding payments to a corporation engaged in providing medical and health care services or engaged in billing and collecting payments with respect to medical and health care services.

For this purpose, an understatement[2] is considered substantial if it exceeds the greater of 10 percent of the tax required to be shown on the year's return or $5,000 ($10,000 for corporations other than S corporations and personal holding companies). In determining whether an understatement is substantial, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the tax return (or a statement attached to the return), provided that the treatment of the disclosed item was not "frivolous" (Treas. Reg. sec. 1.6662-4). Special rules apply to tax shelters.

The term "negligence" includes any failure to make a reasonable attempt to comply with the internal revenue laws, a failure to exercise ordinary and reasonable care in the preparation of a tax return, and a failure to keep adequate books and records or to substantiate items properly (Treas. Reg. sec. 1.6662-3(b)(1)). The term "disregard" includes any careless, reckless, or intentional disregard of rules or regulations (sec. 6662(c)). The penalty for negligence or disregard of rules or regulations does not apply where the position taken is adequately disclosed, the position is not "frivolous", and the taxpayer has adequate books and records and has substantiated items properly (Treas. Reg. sec. 1.6662-3(c)).[3]

A $250 penalty with respect to a return or claim for refund of income tax may be imposed on the preparer if any understatement of tax liability on the return or claim for refund resulted from a position that did not have a realistic possibility of being sustained on its merits and the preparer knew or reasonably should have known of the position (sec. 6694(a)). The penalty is $1,000 per return or claim for refund if the understatement is due to any reckless or intentional disregard of rules or regulations (sec. 6694(b)). These penalties may be avoided where the position taken on the return or claim for refund is adequately disclosed and is not "frivolous" (Treas. Reg. secs. 1.6694-2(c), 1.6694-3(c)(2)).[4]

A "frivolous" position with respect to an item for purposes of all of these penalty provisions is one that is "patently improper"

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[2] An "understatement" of income tax is the excess of the tax required to be shown on the return over the tax imposed which is shown on the return (reduced by any rebates of tax).

[3] In the case of a position contrary to a regulation, the position taken must also represent a good faith challenge to the validity of the regulation.

[4] In the case of a position contrary to a regulation, the position taken must also represent a good faith challenge to the validity of the regulation.

(Treas. Reg. sec. 1.6662-3(b)(3), 1.6662-4(e)(2)(i), 1.6694-2(c)(2), 1.6694-3(c)(2)).

Description of Proposal

Under the proposal, the "reasonable basis" standard would replace the "not frivolous" standard for purposes of the accuracy-related and income tax return preparer penalties. "Reasonable basis" would be intended to be a relatively high standard of tax reporting, that is, significantly higher than "not patently improper." This standard would not be satisfied by a return position that is merely arguable or that is merely a colorable claim.

Under the proposal, a taxpayer could avoid a substantial understatement penalty by adequately disclosing a return position only if the position has at least a reasonable basis. Similarly, a taxpayer could avoid the penalty that applies to disregarding rules or regulations by adequately disclosing a return position only if the position has at least a reasonable basis. The disclosure exception would no longer be relevant with respect to the penalty for negligence, because a taxpayer generally is not considered to have been negligent with respect to a return position, regardless of whether it was disclosed, if the position has a reasonable basis. Also, a preparer could avoid a penalty by adequately disclosing a return position only if the position has at least a reasonable basis.

The proposal would also eliminate the reasonable cause and good faith exception for fraud, because fraud is inconsistent with reasonable cause and good faith.

Effective Date

The proposal would apply to tax returns due (without regard to extensions) after December 31, 1993.

3. Modify tax shelter rules for purposes of the substantial understatement penalty

Present Law

Under present law, a 20-percent penalty applies to any portion of an underpayment of income tax required to be shown on a return that is attributable to a substantial understatement of income tax (sec. 6662). For this purpose, an understatement is considered substantial if it exceeds the greater of (1) 10 percent of the tax required to be shown on the return, or (2) $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). The amount of an understatement of income tax is the excess of the tax required to be shown on the return, over the tax imposed which is shown on the return (reduced by any rebates of tax).

In determining whether an understatement is substantial, the understatement generally is reduced by the portion of the understatement that is attributable to an item for which there was substantial authority or adequate disclosure (sec. 6662(d)(2)). However, in the case of tax shelter items, the understatement is reduced only by the portion of the understatement that is attributable to an item both for which there was substantial authority and with respect to which the taxpayer reasonably believed that the claimed treatment of the item was more likely than not the proper treatment (sec. 6662(d)(2)(C)(i)). Disclosure made with respect to a tax shelter item does not affect the amount of an understatement.

A "tax shelter" is any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement if the principal purpose of such partnership, entity, plan or arrangement is to avoid or to evade Federal income tax (sec. 6662(d)(2)(C)(ii)). An item of income, gain, loss, deduction or credit is a "tax shelter item" if the item is directly or indirectly attributable to the principal purpose of the tax shelter (Treas. Reg. sec. 1.6662-4(g)(3)).

Description of Proposal

Under the proposal, an understatement would be reduced by the portion of the understatement attributable to a tax shelter item only if, in addition to satisfying existing requirements, the taxpayer could demonstrate that the reasonably anticipated after-tax benefits from the taxpayer's investment in the shelter did not significantly exceed the reasonably anticipated net pre-tax economic profit from such investment. Thus, an understatement would be reduced by the portion of the understatement attributable to a tax shelter item only if (1) there was substantial authority for the treatment of the item claimed on the return, (2) the taxpayer reasonably believed that the claimed treatment was more likely than not the proper treatment, and (3) the reasonably anticipated after-tax benefits from the taxpayer's investment in the shelter did not significantly exceed the reasonably anticipated net pre-tax economic profit from such investment. The proposal would not alter the definition of "tax shelter" for purposes of the substantial understatement penalty and, therefore, would apply only to investments in arrangements that would be considered tax shelters without regard to this proposal.

Effective Date

This proposal would apply to tax returns due (without regard to extensions) after December 31, 1993.

4. Information returns relating to the discharge of indebtedness by certain financial entities

Present Law

Under section 61(a)(12), a taxpayer's gross income includes income from the discharge of indebtedness. The Code, however, does not currently require lenders to file information returns with respect to discharged debt.[5]

Pursuant to a 1984 Office of Management and Budget memorandum, Treasury Department guidelines currently require Federal agencies to report forgiven debt amounts exceeding $600 to the Internal Revenue Service (IRS) on a Form 1099-G, except where prohibited by law. The Federal Deposit Insurance Corporation (FDIC) and Resolution Trust Corporation (RTC) do not issue such reports because of concerns that information reporting may violate the Right to Financial Privacy Act of 1978 (RFPA). The RFPA permits such information reporting if the Code specifically requires it.

Description of Proposal

The proposal would require "applicable financial entities" to file information returns with the IRS regarding any discharge of indebtedness (within the meaning of sec. 61(a)(12)) of $600 or more.[6] The information return must set forth the name, address and taxpayer identification number of the person whose debt was discharged, the amount of debt discharged, and the date on which the debt was discharged.[7] The information return must be filed in the manner and at the time specified by the IRS. The same information also must be provided to the person whose debt is discharged by January 31 of the year following the discharge.

For purposes of the proposal, "applicable financial entities" include: (1) the FDIC, the RTC, the National Credit Union

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[5] Lenders are generally required to report any foreclosure or other acquisition of property in satisfaction of a debt secured by that property (sec. 6050J). Such events may effect a discharge of indebtedness. The Treasury Department should issue guidance to coordinate reporting under this section with reporting on foreclosures and abandonments under section 6050J.

[6] Such returns would be required regardless of whether the debtor is subject to tax on the discharged debt. For example, Congress would not expect reporting financial institutions and agencies to determine whether the debtor qualifies for an exclusion under section 108.

[7] The date of discharge would be required to facilitate the use of such information returns with respect to fiscal year taxpayers.

Administration, and any successor or subunit of any of them;[8] (2) any financial institution (described in secs. 581 or 591(a)); (3) any credit union; and (4) any subsidiary of an entity described in (2) or (3) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities.

Under the proposal, the penalties for failure to file correct information reports with the IRS, and to furnish statements to taxpayers, would be similar to those imposed with respect to a failure to provide other information returns. For example, the penalty for failure to furnish statements to taxpayers is generally $50 per failure, subject to a maximum of $100,000 for any calendar year.[9] These penalties would not be applicable if the failure is due to reasonable cause and not to willful neglect.

Effective Date

The proposal would apply to discharges of indebtedness after the date of enactment.

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[8] With respect to these entities, any return required by the bill would be made by the officer or employee appropriately designated to make these returns.

[9] In the case of intentional disregard of the filing requirements, the penalty is not less than $100 per failure and the $100,000 annual limitation does not apply.

F. Treatment of Intangibles

1. Amortization of goodwill and certain other intangibles

Present Law

In determining taxable income for Federal income tax purposes, a taxpayer is allowed depreciation or amortization deductions for the cost or other basis of intangible property that is used in a trade or business or held for the production of income if the property has a limited useful life that may be determined with reasonable accuracy. Treas. Reg. sec. 1.167(a)-(3). These Treasury regulations also state that no depreciation deductions are allowed with respect to goodwill.

The U.S. Supreme Court recently held that a taxpayer able to prove that a particular asset can be valued, and that the asset has a limited useful life which can be ascertained with reasonable accuracy, may depreciate the value over the useful life regardless of how much the asset appears to reflect the expectancy of continued patronage. However, the Supreme Court also characterized the taxpayer's burden of proof as "substantial" and stated that it "often will prove too great to bear." Newark Morning Ledger Co. v. United States, __ U.S.__, 61 U.S.L.W. 4313 at 4320, 4319 (April 20, 1993).

Description of Proposal

In general

An amortization deduction would be allowed with respect to a portion of the basis of certain intangible property (defined as a "section 197 intangible") that is acquired by a taxpayer and that is held by the taxpayer in connection with the conduct of a trade or business or an activity engaged in for the production of income. The amount of the deduction is determined by amortizing 75 percent of the adjusted basis (for purposes of determining gain) of the section 197 intangible ratably over a 14-year period that begins with the month that the intangible is acquired.[1] The remaining 25 percent of basis would not be amortizable. No other depreciation or amortization deduction would be allowed with respect to a section 197 intangible.

The proposal generally would apply to a section 197 intangible regardless of whether it is acquired as part of a trade or business or as a separate asset. The proposal generally would not change the

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[1] In the case of a short taxable year, the amortization deduction is to be based on the number of months in such taxable year.

Federal income tax treatment of self-created intangible property[2] if the intangible is not created in connection with a transaction (or series of related transactions) that involves the acquisition of a trade or business or a substantial portion thereof. A trade or business or substantial portion thereof would include any assets subject to present law section 1060 (i.e., if the assets are of such a character that goodwill or going concern value could under any circumstances attach to the assets) and would also include any franchise, trademark, or tradename.

Except in the case of amounts paid or incurred under certain covenants not to compete (or under certain other arrangements that have substantially the same effect as covenants not to compete) and certain amounts paid or incurred on account of the transfer of a franchise, trademark, or trade name, the proposal generally does not apply to any amount that is otherwise currently deductible (i.e., not capitalized) under present law.

Definition of section 197 intangible

In general

The term "section 197 intangible" is defined as any property that is included in any one or more of the following categories: (1) goodwill and going concern value; (2) certain specified types of intangible property that generally relate to workforce, information base, know-how, customers, suppliers, or other similar items; (3) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof; (4) any covenant not to compete (or other arrangement to the extent that the arrangement has substantially the same effect as a covenant not

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[2] The exception for "self-created" intangibles does not apply to the entering into (or renewal of) a contract for the use of a section 197 intangible. Thus, for example, the exception does not apply to the capitalized costs incurred by a licensee in connection with the entering into (or renewal of) a contract for the use of know-how or other section 197 intangible. These capitalized costs are to be amortized over the 14-year period specified in the proposal.

In addition, the exception for "self-created" intangibles does not apply to: (1) any license, permit, or other right that is granted by a governmental unit or an agency or instrumentality thereof; (2) any covenant not to compete (or other similar arrangement) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (3) any franchise, trademark, or trade name. Thus, for example, the capitalized costs incurred in connection with the development or registration of a trademark or trade name are to be amortized over the 14-year period specified in the proposal.

to compete) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (5) any franchise, trademark, or trade name.

Exceptions and special rules

Certain types of property are specifically excluded from the definition of the term "section 197 intangible." The term "section 197 intangible" does not include: (1) any interest in a corporation, partnership, trust, or estate; (2) any interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract; (3) any interest in land; (4) any interest under an existing lease of tangible property[3]; (6) any interest under an existing indebtedness (except for the deposit base and similar items of a financial institution); (7) a franchise to engage in any professional sport, and any item acquired in connection with such a franchise; (8) fees for professional services or transaction costs incurred by parties to certain wholly or partially tax-free transactions; or (9) purchased mortgage servicing rights not acquired in connection with the acquisition of any other assets constituting a trade or business or substantial portion thereof. (Such purchased mortgage servicing rights must be amortized on a straight-line basis over a 9-year period.)

The term "section 197 intangible" also does not include any of the following, if not acquired in connection with the acquisition of a trade or business or substantial portion thereof: (10) any interest in a film, sound recording, video tape, book, or other similar property; (11) any right to receive tangible property or services; or (12) any interest in a patent or copyright. In addition, the Treasury Department is authorized to issue regulations that exclude certain rights of fixed duration less than 14 years, or rights of fixed amount whose cost is properly recoverable under a method similar to the unit of production method, from the definition of a section 197 intangible.

There are also special rules for certain computer software. First, computer software[4] is not a section 197 intangible (whether or not it is acquired in connection with the acquisition of a trade or business or substantial portion thereof) if it is available for

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[3] The cost of acquiring an interest as lessor under a lease of tangible property where the interest as lessor is acquired in connection with the acquisition of the tangible property is to be taken into account as part of the cost of the tangible property.

[4] Computer software would be defined as any program that is designed to cause a computer to perform a desired function, together with certain incidental and ancillary rights, but would not include any data base other than a data base that is in the public domain and that is incidental to the software (e.g., a dictionary feature used to spell-check a word processing program).

purchase by the general public, is subject to a nonexclusive license, and has not been substantially modified. Second, computer software is not a section 197 intangible if it is not acquired in a transaction involving the acquisition of a trade or business or substantial portion thereof. Computer software that is not a section 197 intangible for either of these reasons must be amortized over 36 months on a straight line basis.

In addition, there is a special rule for certain acquired businesses that had made certain software expenditures. For these businesses, 50 percent of the amortizable basis of all section 197 intangibles (i.e., 50 percent of the amortizable 75 percent of basis) is amortized over 60 months on a straight line basis. The other 50 percent is amortized over 14 years pursuant to the general rule of the proposal. An acquired business qualifies for this treatment if its principal business is software development; software sales, licensing or leasing; the provision of software services; or a combination of these; and a 5- year test is met. Under this test, for the five years ending with the acquisition date, the total of (a) computer software development costs of the acquired business that qualify as research and experimentation expenditures under section 174, plus (b) amortized costs of computer software that was not purchased in connection with the acquisition of a trade or business or substantial portion thereof, must equal at least 17 percent of the greater of (i) total gross receipts, or (ii) total expenditures of the acquired business (including for this purpose any capitalized amounts). An anti-abuse rule would apply to prevent an acquirer from acquiring assets of an enterprise in a series of transactions to manipulate the 17-percent test.

Other rules

Special rules apply if a taxpayer disposes of a section 197 intangible that was acquired in a transaction or series of related transactions and, after the disposition,[5] the taxpayer retains other section 197 intangibles that were acquired in such transaction or series or related transactions. First, no loss is to be recognized by reason of such a disposition. Second, the adjusted bases of the retained section 197 intangibles that were acquired in connection with such transaction or series of related transactions are to be increased by the amount of any loss that is not recognized.[6]

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[5] For this purpose, the abandonment of a section 197 intangible or any other event that renders a section 197 intangible worthless is to be considered a disposition of a section 197 intangible.

[6] These special rules do not apply to a section 197 intangible that is separately acquired (i.e., a section 197 intangible that is acquired other than in a transaction or a series of related transactions that involve the acquisition of other section 197

An acquisition of (or distribution with respect to) an interest in a partnership would not be treated as an acquisition of the section 197 intangibles of the partnership except to the extent of any positive adjustment to the basis of the section 197 intangibles that occurs in connection with such acquisition (or distribution).

Treatment of certain payments to retired or deceased partners

The special treatment of liquidation payments made to a retiring or deceased partner, under which payments for goodwill and certain "unrealized receivables" may be treated as a distributive share of partnership income, would no longer be available except in the case of a general partner of a partnership in which capital is not a material income producing factor.

Study and report regarding backlog of pending cases

The Treasury Department would be directed to conduct a continuing study of the implementation and effects of the proposal, including effects on merger and acquisition activities (including hostile takeovers and leveraged buyouts). The Treasury Department would report the initial results of such study as expeditiously as possible and no later than December 31, 1994, and would provide additional reports annually thereafter.

The Treasury Department would also be required to report annually to the House Ways and Means Committee and the Senate Finance Committee regarding the volume of pending disputes in audit and litigation involving the amortization of intangibles and the progress made in resolving such disputes. The first such report would be made no later than December 31, 1994.

Effective Date

In general

The provision generally would apply to property acquired after the date of enactment of the proposal. A taxpayer may elect to apply the bill to all property acquired after July 25, 1991. In addition, a taxpayer that does not make this election may elect to apply present law (rather than the provisions of the proposal) to

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intangibles). Consequently, a loss may be recognized upon the disposition of a separately acquired section 197 intangible. In no event, however, is the termination or worthlessness of a portion of a section 197 intangible to be considered the disposition of a separately acquired section 197 intangible. For example, the termination of one or more customers from an acquired customer list or the worthlessness of some information from an acquired data base is not to be considered the disposition of a separately acquired section 197 intangible.

property that is acquired after the date of enactment of the proposal pursuant to a binding written contract in effect on the date of enactment of the proposal and at all times thereafter until the property is acquired.

Finally, special "anti-churning" rules would apply to prevent taxpayers from converting existing goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not have been allowable under present law into amortizable property to which the proposal applies. These anti-churning rules would not apply to any section 197 intangible that is acquired from a person with less than a 50-percent relationship to the acquirer if: 1) the seller recognizes gain on the transaction with respect to such intangible; and 2) the seller agrees, notwithstanding any other provision of the Code, to pay a tax on such gain equal to the highest rate of tax imposed by section 1 or 11 of the Code, whichever is applicable.

Treatment of certain payments to retired or deceased partners

The portion of the proposal relating to the treatment of certain payments to retired or deceased partners generally would apply to partners retiring or dying on or after January 5, 1993. The proposal would not apply to any partner who retires on or after January 5, 1993, if a written contract to purchase the partner's interest in the partnership was binding on January 4, 1993 and at all times thereafter until such purchase.

G. Miscellaneous Revenue-Raising Provisions

1. Deny deductions relating to travel expenses paid or incurred in connection with travel of taxpayer's spouse or dependents

Present Law

In general, a taxpayer is permitted a deduction for all ordinary and necessary expenses paid or incurred during the taxable year (1) in carrying on any trade or business and (2) in the case of an individual, for the production of income. Such deductible expenses may include reasonable travel expenses paid or incurred while away from home, such as transportation costs and the cost of meals and lodging.

In the case of ordinary and necessary business expenses, if a taxpayer travels to a destination and while at that destination engages in both business and personal activities, travel expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business. If the trip is primarily personal in nature, expenses while at the destination that are properly allocable to the taxpayer's trade or business are deductible even though the traveling expenses to and from the destination are not deductible (Treas. Reg. sec. 1.162-2(b)(1)).

Under Treasury regulations, if the taxpayer's spouse accompanies the taxpayer on a business trip, expenses attributable to the spouse's travel are not deductible unless it is adequately shown that the spouse's presence on the trip has a bona fide business purpose (Treas. reg. sec. 1.162-2(c)). The performance of some incidental service by the spouse does not cause the expenses to qualify as deductible business expenses. Under the Treasury regulations, the same rules apply to any other members of the taxpayer's family who accompany the taxpayer on such a trip.

Description of Proposal

The proposal would deny a deduction for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying a person on business travel, unless (1) the spouse, dependent, or other individual accompanying the person is a bona fide employee of the person paying or reimbursing the expenses, (2) the travel of the spouse, dependent, or other individual is for a bona fide business purpose, and (3) the expenses of the spouse, dependent, or other individual would otherwise be deductible. No inference is intended as to the deductibility of these expenses under present law. The denial of the deduction would not apply to expenses that would otherwise qualify as deductible moving expenses.

Effective Date

The proposal would be effective for amounts paid or incurred after December 31, 1993.

2. Increase withholding rate on supplemental wage payments

Present Law

Under Treasury regulations, withholding on supplemental wage payments (such as bonuses, commissions, and overtime pay) that are not paid concurrently with wages (or that are paid concurrently with wages, but are separately stated) for a payroll period may be computed using a rate of 20 percent (at the employer's election) (Treas. Reg. sec. 31.3402(g)-1).[1]

Description of Proposal

The proposal would increase the applicable withholding rate on supplemental wage payments to 28 percent.

Effective Date

The proposal would be effective for payments made after December 31, 1993.

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[1] If the employer chooses not to use the 20-percent method, withholding may be computed by aggregating the supplemental payments with regular wages paid within the same calendar year for the last preceding payroll period or the current payroll period. The employer would then use withholding tables to determine the total tax on this aggregate amount. The amount to be withheld for the supplemental wages is the total tax less any amount already withheld for regular wages included in the aggregate amount.

3. Permanent extension of vaccine excise tax

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.

Under the Program, all persons who were immunized with a covered vaccine after the effective date of the Program, October 1, 1988, are prohibited from commencing a civil action in State court for vaccine-related damages unless they first file a petition with the United States Claims Court, where such petitions are assigned to a special master and governed by streamlined procedural rules designed to expedite the proceedings.[1] In these cases, the Federal Government is the respondent party in the proceedings, and the claimant generally must show only that certain medical conditions (or death) followed the administration of a covered vaccine and that the first onset of symptoms occurred within a prescribed time period.[2] Compensation under the Program generally is limited to actual and projected unreimbursed medical, rehabilitative, and custodial expenses, lost earnings, pain and suffering (or, in the event of death, a recovery for the estate) up to

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[1] Persons who received vaccines before the Program's effective date of October 1, 1988 ("retrospective cases") also may be eligible for compensation under the Program if they had not yet received compensation and elected to file a petition with the United States Claims Court on or before January 31, 1991. Under the Program, awards in retrospective cases are somewhat limited compared to "prospective cases" (i.e., those where the vaccine was administered on or after October 1, 1988). Awards in retrospective cases are not paid out of the Vaccine Trust Fund but are paid out of funds specially authorized by Congress. See 42 U.S.C. sec. 300aa-15(i), (j) (appropriating $80 million for fiscal year 1989 and for each subsequent year).

[2] Compensation may not be awarded, however, if there is a preponderance of the evidence that the claimant's condition or death resulted from factors unrelated to the vaccine in question.

$250,000, and reasonable attorney's fees.[3] Only if the final settlement under the Program is rejected may the claimant proceed with a civil tort action in the appropriate State court, where recovery generally will be governed by State tort law principles[4], subject to certain limitations and specifications imposed by the National Childhood Vaccine Injury Act of 1986.[5]

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). Prior to the expiration of the vaccine excise tax, the excise tax per dose was $4.56 for DPT, $0.06 for DT, $4.44 for MMR, and $0.29 for polio vaccines.

The vaccine excise tax expired after December 31, 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

Permanent extension of excise tax and Program funding

The proposal would permanently extend the excise taxes imposed on certain vaccines (at the rates in effect when such

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[3] 42 U.S.C. sec. 300aa-15.

The committee wishes to clarify its understanding that amounts received by a claimant from the Vaccine Trust Fund constitute damages received on account of personal injuries or sickness for purposes of the exclusion from gross income provided by the general rules of section 104(a)(2).

[4] In most State proceedings, significant issues arise whether injuries suffered by an individual after immunization were, in fact, caused by the vaccine administered and whether the manufacturer was at fault in either the manufacture or marketing of the vaccine.

[5] Title III, P.L. 99-660. This Act preempts State tort law to a limited extent by imposing limits on recovery from vaccine manufacturers. Among the limitations are a prohibition on compensation if the injury or death resulted from side effects that were unavoidable; a presumption that manufacturers are not negligent in manufacturing or marketing vaccines if they complied, in all material respects, with Federal Food and Drug Administration requirements; and limits on punitive damage awards.

taxes expired after December 31, 1992). Authorization for compensation to be paid from the Vaccine Trust Fund under the National Vaccine Injury Compensation Program for certain damages resulting from vaccines administered after September 30, 1988, also would be permanently extended.[6]

Study

The Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, would be directed to conduct a study of: (1) the estimated amount that will be paid from the Vaccine Trust Fund with respect to vaccines administered after September 30, 1988; (2) the rates of vaccine-related injury or death with respect to various types of vaccines; (3) new vaccines and immunization practices being developed or used for which amounts may be paid from the Vaccine Trust Fund; (4) whether additional vaccines should be included in the National Vaccine Injury Compensation Program; and (5) the appropriate treatment of vaccines produced by State governmental entities. Not later than one year after the date of enactment, the Secretary of the Treasury would be required to submit a report detailing his findings to the House Committee on Ways and Means and the Senate Committee on Finance.

Effective Date

The extension of coverage under the National Vaccine Injury Compensation Program would be effective for vaccines administered on or after October 1, 1992. The extension of the vaccine excise taxes would be effective on the date of enactment, with a floor stocks tax imposed on vaccines purchased after December 31, 1992, that are being held for sale or use on the date of enactment.

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[6] The committee intends that the Secretary of the Treasury expeditiously (within 60 days of enactment) adopt rules for purposes of Code section 4221 for determining the conditions under which exported vaccines to be administered to individuals not eligible for compensation under the program are not subject to tax.

II. INVESTMENT AND TRAINING PROVISIONS

A. Education and Training Provisions

1. Extension of employer-provided educational assistance

Present Law

Prior to July 1, 1992, an employee's gross income and wages for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (sec. 127). This exclusion, which expired with respect to amounts paid after June 30, 1992, was limited to $5,250 of educational assistance with respect to an individual during a calendar year. Education that did not qualify for the exclusion (e.g., because it exceeded the $5,250 limit) was excludable from income if and only if it qualified as a working condition fringe benefit (sec. 132). To be excluded as a working condition fringe, the cost of the education must have been a job-related deductible expense.

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

Description of Proposal

The proposal would retroactively extend the exclusion for employer-provided educational assistance for 24 months (through June 30, 1994).

The proposal would also clarify the rule under which educational assistance that does not satisfy section 127 may be excluded from income if and only if it meets the requirements of a working condition fringe benefit.

Effective Date

The extension of the exclusion would be effective for taxable years ending after June 30, 1992. The clarification to the working condition fringe benefit rule would be effective for taxable years beginning after December 31, 1988.

2. 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 expired for individuals who began work for an employer after June 30, 1992.

Certification of members of targeted groups

Generally an individual is not treated as a member of a targeted group unless certain certification conditions are satisfied. On or before the day on which the individual begins work for the employer, the employer has to have received or have requested in writing from the designated local agency certification that the individual is a member of a targeted group. In the case of a certification of an economically disadvantaged youth participating in a cooperative education program, this requirement is satisfied if necessary certification is requested or received from the participating school on or before the day on which the individual begins work for the employer.

The deadline for requesting certification of targeted group membership is extended until five days after the day the individual begins work for the employer, provided that, on or before the day the individual begins work, the individual has received a written preliminary determination of targeted group eligibility (a "voucher") from the designated local agency (or other agency or organization designated pursuant to a written agreement with the designated local agency). The "designated local agency" is the State employment security agency.

Authorization of appropriations

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

Description of Proposal

The proposal would extend for 24 months the targeted jobs tax credit for individuals who begin work for the employer after June 30, 1992 and before July 1, 1994. Under this proposal the credit would not apply with respect to individuals who begin work for the employer after June 30, 1994.

Effective Date

The extension of the basic targeted jobs tax credit would be effective for individuals who begin work for the employer after June 30, 1992 and before July 1, 1994.

B. Investment Incentives

1. Extend research tax credit

Present Law

The research and experimentation tax credit ("research tax credit") provides a credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceed its base amount for that year. The credit expired 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. The credit is not available for expenditures attributable to research that is conducted outside the United States. 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).

The 20-percent research tax credit also applies to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain scientific research organizations) 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 expenditures allowed to a taxpayer under section 174 (or any other section) are reduced by an amount

equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.[1]

Description of Proposal

The research tax credit (including the university basic research credit) would be extended for 12 months (i.e., for expenditures paid or incurred during the period July 1, 1993, through June 30, 1994).

The proposal also would add a new rule regarding the determination of the fixed-base percentage of start-up companies. Under the proposal, a taxpayer that did not have gross receipts in at least three years during the 1984-1988 period would be assigned a fixed-base percentage of .03 for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. The taxpayer's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenditures would be as follows: (1) for the taxpayer's sixth year, its fixed-base percentage would be one-sixth of its ratio of qualified research expenditures to gross receipts for its fourth and fifth years; (2) for its seventh year, its fixed-base percentage would be one-third of its ratio for its fifth and sixth years; (3) for its eighth year, its fixed-base percentage would be one-half of its ratio for its fifth through seventh years; (4) for its ninth year, its fixed-base percentage would be two-thirds of its ratio for its fifth through eighth years; and (5) for its tenth year, its fixed-base percentage would be five-sixths of its ratio for its fifth through ninth years. For subsequent taxable years, the taxpayer's fixed-base percentage would be its actual ratio of qualified research expenditures to gross receipts for five years selected by the taxpayer from its fifth through tenth taxable years.

Effective Date

The proposal would apply to expenditures paid or incurred during the period July 1, 1993, through June 30, 1994.

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[1] Taxpayers may alternatively elect to claim a reduced research credit amount in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

2. Eliminate ACE depreciation adjustment

Present Law

A taxpayer is subject to an alternative minimum tax (AMT) to the extent that the taxpayer's tentative minimum tax exceeds the taxpayer's regular income tax liability. A taxpayer's tentative minimum tax generally equals 20 percent (24 percent in the case of an individual) of the taxpayer's alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income (AMTI) is the taxpayer's taxable income increased by certain 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. For AMT purposes, depreciation on most personal property to which the modified Accelerated Cost Recovery System (MACRS) 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 property's class life. The class lives of MACRS property generally are longer than the recovery periods allowed for regular tax purposes.

For taxable years beginning after 1989, the AMTI of a corporation is increased by an amount equal to 75 percent of the amount by which adjusted current earnings (ACE) of the corporation exceed AMTI (as determined before this adjustment). 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 over the class life and again using the straight-line method over the class life. Taxpayers may elect to use either method for regular tax purposes. If a taxpayer uses the straight-line method for regular tax purposes, it must also use the straight-line method for AMT purposes.

Description of Proposal

The depreciation component of the ACE adjustment would be eliminated. Corporations would compute AMT depreciation by using the rules generally applicable to individuals (i.e., the 150-percent declining balance method over the class life of the property for tangible personal property.)

Effective Date

The proposal would be effective for property placed in service after December 31, 1993.

3. Increase expensing for small business

Present Law

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). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

Description of Proposal

The $10,000 amount allowed to be expensed under section 179 would be increased to $15,000.

Effective Date

The proposal would be effective for property placed in service in taxable years beginning after December 31, 1992.

4. Extension of qualified small-issue bonds

Present Law

Interest on certain small issues of private activity bonds is excluded from income if at least 95 percent of the bond proceeds is used to finance manufacturing facilities or agricultural land or property for first-time farmers ("qualified small-issue bonds"). Qualified small-issue bonds are issues having an aggregate authorized face amount of $1 million or less. Alternatively, the aggregate face amount of the issue, together with the aggregate amount of certain related capital expenditures during the six-year period beginning three years before the date of the issue and ending three years after that date, may not exceed $10 million. Special limits apply to these bonds for first-time farmers.

Authority to issue qualified small-issue bonds expired after June 30, 1992.

Description of Proposal

The proposal would extend the authority to issue qualified small-issue bonds for 24 months through June 30, 1994.

Effective Date

The proposal would be effective for bonds issued after June 30, 1992 and before July 1, 1994.

C. Expansion and Simplification of Earned Income Tax Credit

Present Law

Eligible low-income workers can claim a refundable earned income tax credit (EITC) of up to 18.5 percent of the first $7,750 of earned income for 1993 (19.5 percent for taxpayers with more than one qualifying child). The maximum amount of credit for 1993 is $1,434 ($1,511 for taxpayers with more than one qualifying child).

This maximum credit is reduced by 13.21 percent of earned income (or adjusted gross income, if greater) in excess of $12,200 (13.93 percent for taxpayers with more than one qualifying child). In 1993, the EITC is totally phased out for workers with earned income (or adjusted gross income, if greater) over $23,050. 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.

Present law provides that the credit rates for the EITC increase in 1994, 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

The EITC can be received on an advance basis by a worker who elects to furnish a certificate of eligibility to his or her employer. For such a worker, the employer makes an advance payment of the credit at the time wages are paid.

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 1993 is $388.

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 1993 is $465.

Description of Proposal

For taxpayers with one qualifying child, the EITC would be increased to 26.0 percent of the first $7,750 of earned income in 1994. The maximum credit would be $2,015 which will be reduced by 16.16 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. The credit would be completely phased out for taxpayers with earned income (or adjusted gross income, if greater) over $23,470. In 1995 and thereafter, the credit rate would increase to 34.0 percent. The maximum amount of earned income on which the credit could be claimed would be (an estimated) $6,170. Thus, the maximum credit in 1995 would be approximately $2,098. The phase-out rate would remain the same as in 1994.

For taxpayers with two or more qualifying children, the EITC would be increased to 30.0 percent of the first $8,500 of earned income in 1994. The maximum credit would be $2,550 which would be reduced by 15.94 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. Thus, in 1994, the credit would be completely phased out for taxpayers with earned income (or adjusted gross income, if greater) over $27,000. The credit rate would increase over time and equal 34.0 percent in 1995 and 39.0 percent in 1996 and thereafter. The phase-out rate would be 18.06 percent in 1995 and 20.72 percent in 1996 and thereafter.

As under present law, all dollar thresholds for years after 1994 would be indexed for inflation.

The supplemental young child credit and the supplemental health insurance credit would be repealed.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1993.

D. Real Estate Provisions

1. Extension of qualified mortgage bonds and mortgage credit certificates

Present Law

Qualified mortgage bonds

Qualified mortgage bonds ("QMBs") are bonds the proceeds of which are used to finance the purchase, or qualifying rehabilitation or improvement, of single-family, owner-occupied residences located within the jurisdiction of the issuer of the bonds (sec. 143). Persons receiving QMB loans must satisfy a home purchase price, borrower income, first-time homebuyer, and other requirements. Part or all of the interest subsidy provided by QMBs is recaptured if the borrower experiences substantial increases in income and disposes of the subsidized residence within nine years after purchase.

Mortgage credit certificates

Qualified governmental units may elect to exchange QMB authority for authority to issue mortgage credit certificates ("MCCs") (sec. 25). MCCs entitle homebuyers to nonrefundable income tax credits for a specified percentage of interest paid on mortgage loans on their principal residences. Once issued, an MCC remains in effect as long as the loan remains outstanding and the residence being financed continues to be the certificate-recipient's principal residence. MCCs are subject to the same targeting requirements as QMBs.

Expiration

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

Description of Proposal

The proposal would extend the authority to issue QMBs and to elect to trade in private activity bond volume authority for authority to issue MCCs for 24 months through June 30, 1994.

Effective Date

The extension of the QMB and MCC programs would be effective after June 30, 1992 and before July 1, 1994.

2. Extension of the tax credit for low-income residential rental housing

Present Law

In general

A tax credit is allowed in annual installments over ten years for qualifying newly constructed or substantially rehabilitated low-income residential rental housing. For most qualifying housing, the credit has a present value of 70 percent of the qualified basis of the low-income housing units. For housing also receiving other Federal subsidies (e.g., tax-exempt bond financing) and for the acquisition cost (e.g., costs other than rehabilitation expenditures) of existing housing that is substantially rehabilitated, the credit has a present value of 30 percent of qualified costs.

Full-time students

A housing unit generally is not eligible for the low-income housing tax credit if the tenants are full-time students who are not married individuals filing joint returns. Exceptions to this rule allow the credit to be claimed on housing units occupied by persons who are enrolled in certain job training programs or by students who are receiving Aid to Families with Dependent Children (AFDC) payments.

Deep-rent skewing

Generally, the credit amount is based on the qualified basis of the housing units serving low-income tenants. A residential rental project will qualify for the credit only if (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 50 percent of area median income, or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 60 percent of area median income. These income figures are adjusted for family size. The low income set-aside is elected when the project is placed in service.

To qualify under the deep rent skewing exception from the general targeting requirements, at least 15 percent of the low-income units must be occupied by tenants whose incomes do not exceed 40 percent of area median income, the rents on such units must be restricted to 30 percent of the qualifying income limitation, and rents on the market rate units must be at least 200 percent of rents charged on comparable rent restricted units. For projects receiving allocations prior to 1990, rents on market rate units must be at least 300 percent of rents charged on comparable rent restricted units.

Maximum rent

The maximum rent that may be charged a family in a low-income housing tax credit unit depends on the number of bedrooms in that unit. Prior to 1990, maximum allowable rent was determined on the basis of the actual family size of the occupants.

Tenant occupancy

Under the general low-income tenant occupancy requirement, a residential rental project qualifies for the low-income housing tax credit only if at least: (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 50 percent of area median income or, (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 60 percent of area median income.

Income recertification

Generally, the owner of a low-income housing project must annually recertify tenant incomes to meet the low-income tenant occupancy requirements, regardless of whether the building is entirely occupied by low-income tenants.

Tenant protection

The low-income housing tax credit provisions in the Code do not include any specific provisions concerning the grounds for denial of admission to low-income housing projects, for termination of a tenancy, or for refusal to renew the lease of a tenant.

Developmental and operational costs

In general, housing credit agencies cannot allocate more low-income housing tax credits to a project than are necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the ten-year credit period. In making this determination, a housing credit agency must consider (i) the sources and uses of funds and the total financing of the project, (ii) any proceeds expected to be generated by reason of tax benefits and (iii) the percentage of the housing credit dollar amount to be used for project costs other than the costs of intermediaries.

Allocation between buyer and seller in month of disposition

The Code requires that the low-income housing tax credit be divided between a buyer and seller of a low-income housing tax credit project based upon the number of days during the year of disposition that the project was held by each. The Internal Revenue Service has issued guidance that requires a mid-month averaging convention.

The low-income housing tax credit expired after June 30, 1992.

Description of Proposal

The proposal would permanently and retroactively extend the low-income housing tax credit. It would also make the following modifications:

Full-time students

The proposal would provide that a housing unit occupied entirely by full-time students may qualify for the credit if the full-time students are a single parent and his or her minor children and none of the tenants is a dependent of a third party. The amendment would also codify the present-law exception regarding married students filing joint returns (which continues to apply to all buildings placed in service since original enactment of the low-income housing tax credit by the Tax Reform Act of 1986).

Deep-rent skewing

The proposal would allow an irrevocable election by the owner of a low-income building receiving a credit allocation before 1990 to satisfy the 200 percent rent restriction rather than the 300 percent rent restriction. The election would be available only to taxpayers who enter into a compliance monitoring agreement with a housing credit agency. Further, the election would apply only with respect to tenants first occupying any unit in the building after the date of the election, and must be made within 180 days after the date of enactment.

Maximum rent

The proposal would allow an irrevocable election by the owner of a low-income building placed in-service before 1990 to use either apartment size or family size in determining maximum allowable rent. The election would be available only to taxpayers who enter into a compliance monitoring agreement with a housing credit agency. Further, the election would apply only with respect to tenants first occupying any unit in the building after the date of the election, and must be made within 180 days after the date of enactment.

Tenant occupancy

The proposal would authorize the Treasury Department to provide a waiver of penalties for de minimis errors in the application of the low-income tenant occupancy requirement.

Income recertification

The proposal would authorize the Treasury Department to grant a waiver from the annual recertification of tenant income for

tenants in buildings that are occupied entirely by low-income tenants.

Tenant protection

The proposal would provide that (1) an applicant may not be denied admission to a low-income housing tax credit project because the applicant holds a voucher or certificate of eligibility under Section 8 of the Housing Act of 1937; (2) no owner of a project shall terminate a tenancy or refuse to renew a lease of a tenant except for serious or repeated violations of the terms of the lease, for violations of laws or for other good cause (same as section 225(b) of the 1990 National Affordable Housing Act); and (3) the fair housing provisions of the assisted housing titles of the United States Code shall apply to low-income housing tax credit projects.

Developmental and operational costs

The proposal would require a housing credit agency to consider the reasonableness of the developmental and operational costs of a project as an additional factor in making its determination as to the proper amount of low-income housing tax credits to allocate to a project.

Allocation between buyer and seller in month of disposition

The proposal would provide that the buyer and seller may agree to use either the exact number of days or the mid-month convention to determine the division of the credit.

Effective Date

The extension of the low-income housing tax credit would be effective after June 30, 1992. Generally, the proposed modifications would be effective on the date of enactment.

3. Modify passive loss rules for certain real estate persons

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. A similar rule applies with respect to credits from passive activities. Deductions and credits suspended under these rules are carried forward to the next taxable year, and are allowed in full when the taxpayer disposes of his entire interest in the passive activity to an unrelated person. The passive loss rules apply to individuals, estates and trusts, personal service corporations, and in modified form to closely held C corporations.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate. Rental activities (including rental real estate activities) are also treated as passive activities, regardless of the level of the taxpayer's participation. A special exception to this treatment of rental activities permits a taxpayer to treat up to $25,000 of rental real estate losses as nonpassive; this special exception generally is phased out ratably as taxpayers' adjusted gross incomes increase from $100,000 to $150,000.

Description of Proposal

The proposal would provide that an eligible taxpayer's net loss from rental real estate activities in which the taxpayer materially participates generally is allowed to offset income from real property trade or business activities. The loss allowed under the provision may not exceed the least of (1) the taxpayer's net loss from rental real estate activities, (2) the taxpayer's net income from real property trade or business activities which are not passive activities, or (3) the taxpayer's taxable income (determined without regard to this provision). A similar rule applies with respect passive activity credits.

A taxpayer would be eligible if more than half of the personal services he performs in a trade or business are performed in real property trades or businesses in which he materially participates. Personal services performed as an employee would not be treated as performed in a real property trade or business unless the person performing the services has more than a 5-percent ownership interest in the employer. Real property trade or business means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. The provision would apply to taxpayers subject to the passive loss rule, other than closely held C corporations.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1993.

4. Changes relating to real estate investments by pension funds and others

a. Modification of the rules related to debt-financed income

Present Law

In general, a qualified pension trust or an organization that is otherwise exempt from Federal income tax is taxed on income from a trade or business that is unrelated to the organization's exempt purposes (Unrelated Business Taxable Income or "UBTI") (sec. 511). Certain types of income, including rents, royalties, dividends, and interest are excluded from UBTI, except when such income is derived from "debt-financed property." Income from debt-financed property generally is treated as UBTI in proportion to the amount of debt financing (sec. 514(a)).

An exception to the rule treating income from debt-financed property as UBTI 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 real property exception to the debt-financed property rules is available for investments in debt-financed property, only if the following six restrictions are satisfied: (1) the purchase 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

Relaxation of the leaseback and disqualified person restrictions

The proposal would relax the leaseback and disqualified person restrictions to permit a limited leaseback of debt-financed real property to the seller (or a person related to the seller) or to a disqualified person.[1] The exception would apply only where (1) no more than 25 percent of the leasable floor space in a building (or complex of buildings) is leased back to the seller (or related party) or to the disqualified person, and (2) the lease is on commercially reasonable terms, independent of the sale and other transactions.

Relaxation of the seller-financing restriction

The proposal would relax the seller-financing restriction to permit seller financing on terms that are commercially reasonable independent of the sale and other transactions. The proposal would grant authority to the Treasury Department to issue regulations for the purpose of determining commercially reasonable financing terms.

The proposal would not modify the present-law fixed price and participating loan restrictions. Thus, for example, income from real property acquired with seller-financing where the timing or amount of payment is based on revenue, income, or profits from the property generally would continue to be treated as income from debt-financed property, unless some other exception applies.

Relaxation of the fixed price and participating loan restriction for property acquired from financial institutions

The proposal would relax the fixed price and participating loan restrictions for certain sales of real property foreclosed upon by financial institutions.[2] 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), or was held by the selling financial institution at the time that it entered into conservatorship or receivership; (2) any gain recognized by the financial institution with respect to the

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[1] As under present law, a leaseback to a disqualified person is subject to the prohibited transaction rules set forth in section 4975.

[2] For this purpose, financial institutions include financial institutions in conservatorship or receivership, certain affiliates of financial institutions, and government corporations that succeed to the rights and interests of a receiver or conservator.

property is 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 or default; and (4) the present value of the maximum amount payable pursuant to any participation feature cannot exceed 30 percent of the total purchase price of the property (including contingent payments).

Effective Date

The proposal would be effective for acquisitions (and also for leases entered into) on or after January 1, 1994.

b. Repeal of the automatic UBTI rule for publicly-traded partnerships

Present Law

In general, the character of a partner's distributive share of partnership income is the same as if the income had been directly realized by the partner. Thus, whether a tax-exempt organization's share of income from a partnership (other than from a publicly-traded partnership) is treated as unrelated business income depends on the underlying character of the income (sec. 512(c)(1)).

By contrast, a tax-exempt organization's distributive 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 UBTI (sec. 512(c)(2)(B)).

Description of Proposal

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

Effective Date

The proposal would be effective for partnership years beginning on or after January 1, 1994.

c. Permit title-holding companies to receive small amounts of UBTI

Present Law

Section 501(c)(2) provides tax-exempt status to certain corporations organized for the exclusive purpose of holding title

to property and remitting 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 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). 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 certain types of UBTI.[3]

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 (that would otherwise disqualify the company) 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. 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) would not jeopardize the title-holding company's tax-exempt status, but nonetheless, would be subject to tax as UBTI.

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

Effective Date

The proposal would be effective for taxable years beginning on or after January 1, 1994.

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

d. Exclusion from UBTI of gains from the disposition of real property acquired from financial institutions in conservatorship or receivership

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 a trade or business are not excluded from UBTI (the "dealer UBTI rule") (sec. 512(b)(5)(B)).

Description of Proposal

The proposal would provide an exception to the dealer UBTI rule by excluding gains and losses from the sale, exchange or other disposition of certain real property and mortgages acquired from financial institutions that are in conservatorship or receivership. Only real property and mortgages owned by a financial institution (or that was security for a loan held by the financial institution) at the time that the institution entered conservatorship or receivership would be eligible for the exception.

The exclusion would be limited to properties designated as disposal property within nine months of acquisition, and disposed of within two-and-a-half years of acquisition. The two-and-a-half year disposition period could be extended by the Secretary if an extension is necessary for the orderly liquidation of the property. No more than one-half by value of properties acquired in a single transaction could be designated as disposal property.

The exclusion would not be available for properties that are improved or developed to the extent that the aggregate expenditures on development do not exceed 20 percent of the net selling price of the property.

Effective Date

The proposal would be effective for property acquired on or after January 1, 1994.

e. Exclusion of certain option premiums and loan commitment fees 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 premiums from unexercised options on real estate and loan commitment fees are UBTI.

Description of Proposal

The proposal would expand the current exception for gains on the lapse or termination of options on securities to gains or losses from such options (without regard to whether they are written by the organization), from options on real property, and from the forfeiture of good-faith deposits (that are consistent with established business practice) for the purchase, sale or lease of real property.

In addition, the proposal would exclude loan commitment fees from UBTI. For purposes of this provision, loan commitment fees are non-refundable charges made by a lender to reserve a sum of money with fixed terms for a specified period of time. These charges are to compensate the lender for the risk inherent in committing to make the loan (e.g., for the lender's exposure to interest rate changes and for potential lost opportunities).

Effective Date

The proposal would be effective for premiums or loan commitment fees that are received on or after January 1, 1994.

f. Relaxation of limitations on investments in real estate investment trusts by pension funds

Present Law

A real estate investment trust ("REIT") is not taxed on income distributed to shareholders. A corporation does not qualify as a REIT if at any time during the last half of its taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by five or fewer individuals ("the five or fewer rule"). A domestic pension trust is treated as a single individual for purposes of this rule.

Dividends paid by a REIT are not UBTI,[4] unless the stock in the REIT is debt-financed. Depending on its character, income earned by a partnership may be UBTI (sec. 512(c)). Special rules treat debt-financed income earned by a partnership as UBTI (sec. 514(c)(9)(B)(vi)).

Description of Proposal

Qualification as a REIT

[4] See Rev. Rul. 66-151, 1966-1 C.B. 151.

Under the proposal, a pension trust generally would not be treated as a single individual for purposes of the five-or-fewer rule. Rather, the proposal would treat beneficiaries of the pension trust as holding stock in the REIT in proportion to their actuarial interests in the trust. This rule would not apply if disqualified persons, within the meaning of section 4975(e)(2) (other than by reason of subparagraphs (B) and (I)), together own five percent or more of the value of the REIT stock and the REIT has earnings and profits attributable to a period during which it did not qualify as a REIT.[5]

Under the proposal, a REIT could not be a personal holding company and, therefore, would not be subject to the personal holding company tax on its undistributed income.

Unrelated business taxable income

Under the proposal, certain pension trusts owning more than 10 percent of a REIT would treat a percentage of dividends from the REIT as UBTI. This percentage would be the gross income derived from an unrelated trade or business (determined as if the REIT were a pension trust) divided by the gross income of the REIT for the year in which the dividends are paid. Dividends would not treated as UBTI, however, unless this percentage is at least five percent.

The UBTI rule would apply only if the REIT qualifies as a REIT by reason of the above modification of the five or fewer rule. Moreover, the UBTI rule would apply only if (1) one pension trust owns more than 25 percent of the value of the REIT, or (2) a group of pension trusts individually holding more than 10 percent of the value of the REIT collectively own more than 50 percent of the value of the REIT.

Effective Date

The proposal would apply to taxable years beginning on or after January 1, 1994.

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[5] Moreover, as under present law, any investment by a pension trust must be in accordance with the fiduciary rules of the Employee Retirement Income Security Act ("ERISA") and the prohibited transaction rules of the Code and ERISA.

5. 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 (other than land) 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 by 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 by using the straight-line method and a recovery period of 40 years.

Description of Proposal

For regular tax purposes, nonresidential real property would be depreciated using the straight-line method and a recovery period of 38 years.

Effective Date

The proposal generally would apply to property placed in service on or after February 25, 1993. The proposal would not apply to property that a taxpayer places in service before January 1, 1994, if (1) the taxpayer or a qualified person entered into a binding written contract to purchase or construct the property before February 25, 1993, or (2) construction of the property was commenced by or for the taxpayer or a qualified person before February 25, 1993. A qualified person for this purpose is any person who transfers rights in such a contract or such property to the taxpayer without first placing the property in service.

E. Luxury Excise Tax; Diesel Fuel Tax for Motorboats

1. Repeal of luxury excise tax on boats, aircraft, jewelry, and furs; Indexing of luxury excise tax on automobiles

Present Law

Present law imposes a 10-percent excise tax 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 also applies to subsequent purchases of component parts and accessories occurring within six months of the date the automobile, boat, or aircraft is placed in service.

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 not apply to items used in trade or business.

The tax applies to sales before January 1, 2000.

Description of Proposal

Repeal of luxury tax on boats, aircraft, jewelry, and fur

The proposal would repeal the luxury excise tax imposed on boats, aircraft, jewelry, and furs.

Indexing of tax on automobiles

The proposal would modify the luxury excise tax on automobiles to provide that the $30,000 threshold is indexed annually for inflation occurring after 1990. Consequently, the applicable threshold for 1993 will be $30,000 increased by the 1991 and 1992 inflation rates, or by 8.49 percent which when rounded to the nearest $100 is a threshold of $32,500.

Exemption for certain equipment installed on passenger vehicles for use by disabled individuals

The proposal would provide that the luxury excise tax does not apply to a part or accessory installed on a passenger vehicle to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle, in order to compensate for the effect of the disability. This exception does not apply to accessories commonly available from the manufacturer or dealer, such as power steering, power door locks, power seats, or power windows.

<u>Exemption for demonstrator vehicles</u>

The proposal would exempt passenger vehicle dealers from paying the luxury tax on vehicles used as demonstrators for potential customers. Under the proposal, the tax, if any, is to be assessed and paid on the sales price of the vehicle when the vehicle is sold.

<u>Effective Date</u>

The repeal of the luxury excise taxes on boats, aircraft, jewelry, and furs would be effective for sales on or after January 1, 1993. The indexation of the threshold applicable to passenger vehicles would be effective for sales on or after January 1, 1993. The provision relating to the purchase of accessories or modifications by disabled persons would be effective for purchases after December 31, 1990. The provision relating to the use before sale of demonstrator vehicles would be effective for vehicles used after December 31, 1992.

Persons entitled to a refund may request it from the seller from whom the taxed item was purchased. The seller then obtains the refund as provided under present-law Code section 6416.

2. Impose excise tax on diesel fuel used in noncommercial motorboats

<u>Present Law</u>

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 is taxed at 2.5 cents per gallon.

The revenues from these taxes, minus the 2.5 cents per gallon General Fund rate are deposited in the Highway Trust Fund (through September 30, 1999), the National Recreational Trails Trust Fund (through September 30, 1997), or the Aquatic Resources Trust Fund (through September 30, 1997). 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.[1]

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[1] A separate proposal would extend the 2.5-cents-per-gallon rate through September 30, 1999, and transfer applicable highway-related revenues to the Highway Trust Fund for the extended period. (See Item I.D.2., above.)

An additional 0.1-cent-per-gallon tax applies to these fuels to finance the Leaking Underground Storage Trust Fund, generally through December 31, 1995.

Diesel fuel used in motorboats is not currently taxed.

Description of Proposal

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

The tax would be collected at the same point in the distribution chain as the highway diesel fuel tax.[2]

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

Effective Date

The proposal would be effective after December 31, 1993 and before January 1, 2000.

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[2] A separate proposal would modify the point of collection for highway diesel fuel. (See Item I.D.1., above).

F. Other Provisions

1. Extend AMT treatment of gifts of appreciated property.

Present Law

Donations of appreciated property

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 is limited to the taxpayer's basis in the property.[2] 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.

For taxable years beginning after 1989, the AMTI of a corporation is increased by 75 percent of the amount by which adjusted current earnings (ACE) exceeds AMTI (calculated before this adjustment). ACE generally is computed pursuant to the rules that a corporation uses to determine its earnings and profits (sec. 56(g)).

Valuation procedures

Present law and current IRS practice do not provide for a procedure by which a taxpayer may seek determination of 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)).

[2] Section 170(e)(3) provides an augmented deduction for certain corporate contributions of inventory property for the care of the ill, the needy, or infants.

IRS' position with respect to the value of property prior to the taxpayer donating the property to a charitable organization. However, if a taxpayer claims a charitable contribution deduction for a noncash gift in excess of $5,000 per item or group of similar items (other than certain publicly traded securities), the taxpayer must attach to his income tax return a separate form (Form 8283), which provides specific information on the donated property and which is signed by a qualified appraiser.[3]

Description of Proposals

Permanent AMT relief for donated appreciated property

The treatment of contributions of appreciated property (real, personal, and intangible) as a tax preference for AMT purposes would be eliminated. In addition, the proposal would provide that no adjustment related to the earnings and profits effects of any charitable contribution shall be made in computing the ACE component of the corporate AMT.

Thus, the difference between the fair market value of donated appreciated property and the adjusted basis of such property would not treated as a tax preference item for alternative minimum tax (AMT) purposes. If a taxpayer makes a gift to charity of property (other than inventory or other ordinary income property, short-term capital gain property, or certain gifts to private foundations) that is real property, intangible property, or tangible personal property the use of which is related to the donee's tax-exempt purpose, the taxpayer would be allowed to claim a deduction for both regular tax and AMT purposes in the amount of the property's fair market value (subject to present-law percentage limitations).[4]

Treasury report on advance valuation procedure

Not later than one year after the date of enactment of the bill, the Secretary of the Treasury would be required to submit a report to the House Committee on Ways and Means and the

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[3] The Form 8283 must be attached to the income tax return (Form 1040) in all cases where total noncash contributions exceed $500, but the Form 8283 need not be signed by a qualified appraiser unless the $5,000 threshold per item or group of similar items is exceeded. In the case of donated art for which a deduction of $20,000 or more is claimed, a complete copy of the signed appraisal must be attached to the Form 8283.

[4] Contributions of inventory or other ordinary income property, short-term capital gain property, and certain gifts to private foundations would continue to be governed by present-law rules.

Senate Committee on Finance, reporting on the development of a procedure under which a taxpayer could elect to seek an agreement with the Secretary as to the value of tangible personal property prior to the donation of such property to a qualifying charitable organization (provided that time limits for donation and any other conditions contained in the agreement are satisfied). The report should address the setting of possible threshold amounts for claimed value (and the payment of fees by a taxpayer) in order for a taxpayer to seek agreement under the procedure, possible limitations on applying the procedure only to items with significant artistic or cultural value, and recommendations for legislative action needed to implement the procedure.

Effective Date

The proposal governing the AMT treatment of gifts of appreciated property would be effective for contributions of tangible personal property made after June 30, 1992, and contributions of other property made after December 31, 1992.

The Treasury Department would be directed to report to Congress not later than one year after enactment on the development of an advance valuation procedure.

2. Substantiation and disclosure of charitable contributions

Present Law

An individual taxpayer who itemizes deductions must separately state (on Schedule A to the Form 1040) the aggregate amount of charitable contributions made by cash or check and the aggregate amount made by donated property other than cash or check.

A taxpayer is not required to provide specific information on his or her return regarding a claimed charitable contribution made by cash or check; nor in such a case is a donee organization required to file an information return with the IRS, regardless of the amount of cash or check involved. However, taxpayers must provide certain information (on Form 8283) if the amount of the claimed deduction for all noncash contributions exceeds $500.[1]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the payor receives an economic benefit is not deductible under section 170, except to the extent that the taxpayer can demonstrate that the payment exceeds the fair market value of the benefit received from the charity.[2]

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[1] If the claimed deduction for a noncash gift exceeds $5,000 per item or group of similar items (other than certain publicly traded securities), a qualified appraiser must sign the Form 8283, and an authorized representative of the donee charity also must sign the Form 8283, acknowledging receipt of the gift and providing certain other information. In certain situations, information reporting by the donee charity is required if it subsequently disposes of donated property (sec. 6050L).

[2] See, e.g., Rev. Rul. 67-246, 1967-2 C.B. 104.

Under current IRS practice, certain small items and token benefits (e.g., key chains and bumper stickers) that have insubstantial value are disregarded, such that the full amount of the contribution is deductible. Rev. Proc. 90-12, 1990-1 C.B. 471, provides that tokens or benefits given to the donor in connection with a contribution will be considered to have insubstantial value if (1) the payment occurs in the context of a fundraising campaign in which the charity informs patrons how much of their payment is a deductible contribution, <u>and</u> (2) <u>either</u> (a) the fair market value of all the benefits received in connection with the payment is not more than two percent of the payment, or $50, <u>whichever is less</u>, <u>or</u> (b) the payment made by the patron is $25 or more (adjusted for inflation) and the only benefits received in connection with the payment are token items (e.g., key chains or mugs) that bear the organization's name or logo and that (in the aggregate) are within

The Code does not require a tax-exempt organization that is eligible to receive tax-deductible contributions to state explicitly, in its solicitations for support from members or the general public, whether an amount paid to the organization is deductible as a charitable contribution or whether all or part of the payment constitutes consideration for goods or services furnished to the payor.[3] In contrast, tax-exempt organizations that are not eligible to receive tax-deductible contributions are required to state expressly in certain fund-raising solicitations that contributions or gifts to the organization are not deductible as charitable contributions for Federal income tax purposes (sec. 6113).[4] A penalty is imposed on such organizations for failure to comply with the section 6113 disclosure requirement, unless reasonable cause is shown (sec. 6710).

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

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the limits for "low-cost items" under section 513(h)(2). See also Rev. Proc. 92-49, 1992-26 IRB 18 (amplifying Rev. Proc. 90-12, by allowing charities to distribute certain low-cost items to contributors without affecting the deductibility of the contribution).

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

[4] However, the disclosure requirement of section 6113 does not apply to an organization the gross receipts of which in each taxable year are normally not more than $100,000, nor does the disclosure requirement apply to any solicitation made by letter or telephone call if such letter or call is not part of a coordinated fundraising campaign soliciting more than 10 persons during the calendar year (sec. 6113(b)(2)(A) and (c)(2)).

[5] See section 6033(a)(2) and Rev. Proc. 83-23, 1983-1 C.B. 687.

contributed, bequeathed, or devised $5,000 or more (in cash or other property) during the taxable year.[6]

Description of Proposals

The following two proposals would require substantiation and disclosure relating to certain charitable contributions:

Substantiation requirement

Section 170 would be amended to provide that no deduction would be allowed under that section for any contribution of $250 or more[7] unless the taxpayer has written substantiation from the donee organization of the contribution (including a good faith estimate of the value of any good or service that has been provided to the donor in exchange for making the gift to the donee).[8]

This proposal would not impose an information reporting requirement upon charities; rather, it would place the responsibility upon taxpayers who claim an itemized deduction for a contribution of $250 or more to request (and maintain in their records) substantiation from the charity of their contribution (and any good or service received in exchange).[9]

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[6] See section 6033(b)(5) and Treas. Reg. sec. 1.6033-2(a)(2)(ii)(f). The names and addresses of substantial contributors to a public charity must be reported to the IRS but are not subject to public inspection (sec. 6104(e)(1)(C)).

[7] Separate payments generally would be treated as separate contributions and would not be aggregated for the purposes of applying the $250 threshold. In cases of contributions paid by withholding from wages, the deduction from each paycheck would be treated as a separate payment. However, it would be expected that the Treasury Department will issue anti-abuse rules to prevent avoidance of the substantiation requirement by a contributor simply writing multiple checks on the same date.

[8] If the donee organization provided no goods or services to the taxpayer in consideration of the taxpayer's contribution, the written substantiation would be required to include a statement to that effect. The substantiation need not contain the taxpayer's social security number or taxpayer identification number (TIN).

[9] In the case where a taxpayer makes a noncash contribution claimed by the taxpayer to be worth $250 or more, the taxpayer would be required to obtain from the charity a receipt that describes the donated property (and indicates whether any good or service was given to the taxpayer in exchange), but the proposal specifically provides that the charity would not be required to

Taxpayers would not be permitted to rely solely on a canceled check as substantiation for a donation of $250 or more.

Under the proposal, the substantiation must be obtained by the taxpayer prior to filing his or her return for the taxable year in which the contribution was made (or if earlier, the due date, including extensions, for filing such return).[10] Substantiation would not be required if the donee organization files a return with the IRS (in accordance with Treasury regulations) reporting information sufficient to substantiate the amount of the deductible contribution.

The proposal explicitly would provide that, if in return for making a contribution of $250 or more to a religious organization, a donor receives in return solely an intangible religious benefit that generally is not sold in commercial transactions outside the donative context (e.g., admission to a religious ceremony[11]), then the substantiation obtained from the charity need not place a monetary value on such religious benefit, but need only indicate the amount contributed by the donor and briefly describe the religious benefit furnished to the donor.

Information disclosure for quid pro quo contributions

A charitable organization that receives a quid pro quo contribution in excess of $75 (meaning a payment exceeding $75 "made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization") would be required, in connection with the

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value the property it receives from the taxpayer.

[10] The proposal requires that the written acknowledgment provide information sufficient to substantiate the amount of the deductible contribution, but the acknowledgment need not take any particular form. Thus, for example, acknowledgments could be made by letter, postcard, or computer-generated forms. Further, a donee organization could prepare a separate acknowledgment for each contribution, or could provide donors with periodic (e.g., annual) acknowledgments that set forth the required information for each contribution of $250 or more made by the donor during the period. It is intended that a charitable organization that knowingly provides a false written substantiation to a donor would be subject to the penalties provided for by section 6701 for aiding and abetting an understatement of tax liability.

[11] This exception would not apply, for example, to tuition for education leading to a recognized degree, travel services, or consumer goods. However, it is intended that de minimis tangible benefits furnished to contributors that are incidental to a religious ceremony (such as wine) generally could be disregarded.

solicitation or receipt of such a contribution, to provide a written statement to the donor that (1) informs the donor that the amount of the contribution that is deductible for Federal income tax purposes is limited to the excess of the amount of any money (and the value of any property other than money) contributed by the donor over the value of the goods or services provided by the organization, and (2) provides the donor with a good faith estimate of the value of goods or services furnished to the donor by the organization.[12]

The disclosure requirement would apply to all quid pro quo contributions where the donor makes payment of more than $75.[13] Thus, for example, if a charity receives a $100 contribution from a donor, in exchange for which the donor receives a dinner valued at $40, then the charity must inform the donor in writing that only $60 is deductible as a charitable contribution. However, the proposal would not apply if only de minimis, token goods or services are given to a donor (see Rev. Procs. 90-12 and 92-49, discussed above). In addition, as with the substantiation proposal (described above), the proposal would not apply to a contribution, in return for which the contributor receives solely an intangible religious benefit that generally is not sold in a commercial context outside the donative context.[14] Furthermore, the proposal would not apply to transactions that have no donative element (e.g., sales of goods by a museum gift shop that are not, in part, donations).

The proposal also would provide that penalties ($10 per contribution, but capped at $5,000 per particular fundraising event or mailing) may be imposed upon charities that fail to make the required disclosure, unless the failure was due to reasonable cause. The penalties would apply if an organization either fails to make any disclosure in connection with a quid

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[12] It is intended that the disclosure would be made in a manner that is reasonably likely to come to the attention of the donor. For example, a disclosure of the required information in small print set forth within a larger document might not meet the requirement.

[13] For purposes of the $75 threshold, separate payments made at different times of the year with respect to separate fundraising events would generally not be aggregated. However, to prevent avoidance of the quid pro quo disclosure requirement by a contributor simply writing multiple checks on the same date, contributions that are part of a single transaction would be aggregated for purposes of the $75 threshold.

[14] No inference would be intended, however, whether or not any payment outside the scope of the quid pro quo disclosure proposal or substantiation proposal is deductible (in full or in part) under the present-law requirements of section 170.

pro quo contribution or makes a disclosure that is incomplete or inaccurate (e.g., an estimate not determined in good faith of the value of goods or services furnished to the donor).

Effective Date

The proposals would be effective for contributions made after December 31, 1993.[15]

[15] It is intended that, following enactment of the proposals, the Secretary of the Treasury will expeditiously issue a notice or other announcement providing guidance with respect to the substantiation and disclosure proposals. In this regard, it is expected that such Treasury guidance will urge charities to assist taxpayers in meeting the substantiation requirement.

3. Permanent extension of General Fund transfer to Railroad Retirement Tier 2 Fund

Present Law

A portion of the Railroad Retirement Tier 2 benefits are included in gross income of recipients (similar to the treatment accorded recipients of private pensions) for Federal income tax purposes. The proceeds from the income taxation of Railroad Retirement Tier 2 benefits received prior to October 1, 1992, have been transferred from the General Fund of the Treasury to the railroad retirement account. Proceeds from the income taxation of benefits received after September 30, 1992 would 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 proposal would be effective for income taxes on benefits received after September 30, 1992.

4. Temporary extension of health insurance deduction for self-employed individuals

Present Law

Under present law, an incorporated business can generally deduct, as an employee compensation expense, the full cost of any health insurance coverage provided for its employees (including owners serving as employees) and its employees' spouses and dependents. Self-employed individuals can fully deduct the cost of health insurance for employees as employee compensation, but can only deduct the cost of health insurance coverage for the individual and his or her dependents to the extent that the cost of the coverage, together with other allowable medical expenses, exceeds 7.5 percent of adjusted gross income. Other individuals (e.g., employees who are not covered by an employer-sponsored plan) who purchase health insurance can deduct the cost of the insurance only to the extent that it, together with their other medical expenses, exceeds 7.5 percent of adjusted gross income.

For coverage prior to July 1, 1992, a self-employed individual was allowed to deduct as a business expense up to 25 percent of the amount paid for health insurance coverage for the taxpayer, the taxpayer's spouse, and the taxpayer's dependents. Only amounts paid prior to July 1, 1992, for coverage before that date were eligible for the deduction. The deduction was not allowed if the self-employed individual or his or her spouse was eligible for employer-paid health benefits.

Description of Proposal

The 25-percent deduction would be extended retroactively from July 1, 1992, through December 31, 1993. In addition, the proposal would provide that the determination of whether a self-employed individual or his or her spouse is eligible for employer-paid health benefits is made on a monthly basis.

Effective Date

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

III. INCREASE IN STATUTORY LIMIT ON THE PUBLIC DEBT

Present Law

The statutory limit on the public debt currently is $4.37 trillion. It was set at this level temporarily in P.L. 103-12, enacted into law on April 6, 1993. The current debt limit will expire after September 30, 1993.

Description of Proposal

The proposal would repeal the temporary limit that expires after September 30, 1993, and instead increase the statutory limit on the public debt to $4.9 trillion. The new debt limit would have no expiration date.

Effective Date

The proposal would be effective on the date of enactment.

IV. OUTLAY-RELATED REVENUE PROVISIONS

A. Expansion of 45-Day Interest-Free Period for Certain Refunds

Present Law

No interest is paid by the Government on a refund arising from an original 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 (sec. 6611(e)).

There is no parallel rule for refunds of taxes other than income taxes (e.g., 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

No interest would 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 would apply 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 would be paid by the Government for that period of up to 45 days (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 would apply to IRS-initiated adjustments (whether due to computational adjustments or audit adjustments). With respect to these adjustments, the IRS would pay interest for 45 fewer days than it otherwise would.

Effective Date

The extension of the 45-day processing rule would be effective for returns required to be filed (without regard to extensions) on or after January 1, 1994. The amended return rule would be

effective for amended returns and claims for refunds filed on or after January 1, 1995 (regardless of the taxable period to which they relate). The rule relating to IRS-initiated adjustments would apply to refunds paid on or after January 1, 1995 (regardless of the taxable period to which they relate).

B. BATF User Fees for Processing Applications for Alcohol Certificates of Label Approval

Present Law

The Treasury Department's Bureau of Alcohol, Tobacco, and Firearms (BATF) is required to approve all alcoholic beverage labels and conduct various laboratory analyses to assure compliance with the Federal Alcohol Administration Act (27 U.S.C., Chapter 8 and Chapter 51 of the Internal Revenue Code). There is currently no charge or fee for these BATF services.

Under the Internal Revenue Code, annual alcohol occupational excise taxes are imposed as follows:

Producers of distilled spirits, wines or beer (secs. 5081, 5091)	$1,000 per year per premise[1]
Wholesale dealers of liquors, wines or beer (sec. 5121)	$500 per year
Retail dealers in liquors, wines or beer (sec. 5121)	$250 per year
Nonbeverage use of distilled spirits (sec. 5131)	$500 per year
Industrial use of distilled spirits (sec. 5276)	$250 per year

These annual alcohol occupational tax rates are as enacted in the Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203, "1987 Act"), effective on January 1, 1988. The 1987 Act increased the wholesale and retail alcohol occupational taxes and imposed new occupational taxes on distilled spirits, wine and beer producers as well as for industrial users of distilled spirits.

Description of Proposal

The proposal would establish BATF user fees for the processing of applications for certificates of alcohol label approval (or exemptions therefrom) required by the Federal Alcohol Administration Act and formula (and statement of process) reviews or laboratory tests and analyses performed under that Act and the Internal Revenue Code and regulations.

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[1] Tax is $500 per year per premise for businesses with gross receipts of less than $500,000 in the preceding taxable year.

The Secretary of the Treasury would be authorized to implement the user fee program and to establish fee rates: not less than $50 for each application and not less than $250 for each formula (and statement of process) review or test and analysis. The fees charged under this program are to be determined so that the Secretary estimates that the aggregate of such fees received during any fiscal year will be $5 million. A maximum of $5 million of the fees under the proposal are to be offsetting receipts deposited in the Treasury and ascribed to BATF's Compliance Alcohol Program.

Effective Date

The proposal would be effective for applications filed and for formula (and statement of process) reviews or tests and analyses initiated 90 days from the date of enactment.

C. Use of Harbor Maintenance Trust Fund for Administrative Expenses

Present Law

Under present law, amounts in the Harbor Maintenance Trust Fund ("Harbor Trust Fund") are available, as provided by appropriation Acts, for making expenditures:

(1) under section 210(a) of the Water Resources Development Act of 1986 (Corps of Engineers costs for dredging and maintaining harbors at U.S. ports);

(2) for payments of rebates of certain St. Lawrence Seaway tolls or charges; and

(3) for payment of administrative expenses incurred by the Department of the Treasury in administering the harbor maintenance excise tax (but not more than $5 million per fiscal year) for periods during which no Customs processing fee applies under the Consolidated Omnibus Budget Reconciliation Act of 1985 ("1985 Act").

The Customs processing fee is currently scheduled to expire after September 30, 1995.[1] Thus, since the Customs processing fee is in effect under the 1985 Act, the Harbor Trust Fund is not permitted to be used for such Treasury administrative expenses. The Customs Service generally has the responsibility for collecting and administering the harbor maintenance excise tax. The Corps of Engineers and the Department of Commerce generate certain data related to shipments of commercial cargo.

Description of Proposal

The proposal would provide up to $5 million per fiscal year from the Harbor Trust Fund for the Department of the Treasury to use for administering the existing harbor maintenance excise tax by removing the current Harbor Trust Fund restriction against such use. The proposal would specify that such Harbor Trust Fund amounts are permitted to be used for the Treasury Department's (including the Customs Service's) related administrative expenses and for reimbursing the Corps of Engineers and the Department of Commerce for administrative expenses related to the harbor maintenance excise tax.

Effective Date

The proposal would apply to fiscal years beginning after the date of enactment.

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[1] A separate provision in the House-passed bill (H.R. 2264) (not described in this document) would extend the current Customs processing fee for three years, through September 30, 1988.

D. Increase Amount of Presidential Election Campaign Fund Checkoff

Present Law

The Presidential Election Campaign Fund ("Fund") provides for public financing of a portion of qualified Presidential election campaign expenditures, and certain qualified convention costs (sec. 9001 et seq.). The Fund is financed through the voluntary designation by individual taxpayers on tax returns of $1 of tax liability, which is commonly known as the Presidential election campaign checkoff. The Treasury Department accumulates revenues in the Fund over a four-year period, and then disburses funds to eligible candidates for President, Vice President, and conventions during the Presidential election year.

Description of Proposal

The amount of the checkoff would be increased from $1 to $3.

Effective Date

The proposal would be effective for tax returns filed after December 31, 1993.

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

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (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). No tax information may be furnished by the IRS to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

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 Internal Revenue Service and Social Security Administration 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 is required to comply with the safeguards currently contained in the Code and in section 1137(c) of the Social Security Act (governing the use of disclosed tax information). These safeguards include independent verification of tax data, notification to the individual concerned, and the opportunity to contest agency findings based on such information.

The DVA disclosure provision is scheduled to expire after September 30, 1997.

Description of Proposal

The proposal would extend the authority to disclose tax information to the DVA for one year, through September 30, 1998.

Effective Date

The proposal would apply after September 30, 1997.

F. Access to Tax Information by the Department of Education

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information except to the extent specifically authorized by the Code (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). No tax information may be furnished by the Internal Revenue Service (IRS) to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

The IRS may disclose to the Department of Education the mailing address of taxpayers who have defaulted on certain student loans. The Department of Education may in turn make this information available to its agents and to the holders of such loans (and their agents) for the purpose of locating the taxpayers and collecting the loan.

Description of Proposal

The proposal would give the Department of Education access to certain tax return information in order to implement a direct student loan program. The only information the Department of Education would be permitted to obtain is the name, address, taxpayer identification number, filing status, and adjusted gross income of the former student. Disclosure of this information could be made only to Department of Education employees and could only be used by these employees in establishing the appropriate income-contingent repayment amount for an applicable student loan. Applicable student loans would be loans under the new direct student loan program and other student loans that are in default and have been assigned to the Department of Education. The Department of Education and its employees would be subject to the restrictions on unauthorized disclosure in present law.

The proposal would also permit the Department of Education to obtain the mailing address of any taxpayer who owes an overpayment (i.e., has received more than the proper amount) on a Federal Pell Grant or who has defaulted on certain additional student loans administered by the Department of Education.

The proposal would require the Treasury Department, in consultation with the Department of Education, to conduct a study of the feasibility of student loan repayment through wage withholding or other means involving the Internal Revenue Service. The study would include an examination of (1) whether the IRS could conduct such a system of student loan repayment within its current resources and without impairing its ability to collect tax revenues, (2) the impact of increased disclosure of tax information on voluntary compliance with the tax laws, (3) the effect of such a system of student loan repayment on collections and repayment of such loans, and (4) the ability of the IRS to service student loans. The study would be required to be submitted to the Congress within six months of the date of enactment. If the Treasury Department were to find that the IRS's current resources are inadequate to permit the IRS to increase its involvement in student loan collection, then it would be asked to identify the amount of additional resources or appropriations needed.

The authority to disclose tax information to the Department of Education for purposes of establishing the direct student loan program would expire on September 30, 1998.

The authority to permit the Department of Education to obtain the mailing address of any taxpayer who owes an overpayment on a Federal Pell Grant or who has defaulted on certain additional student loans administered by the Department of Education would be permanent.

Effective Date

The proposal would be effective on the date of enactment.

G. Access to Tax Information by the Department of Housing and Urban Development

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (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). No tax information may be furnished by the IRS to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

Description of Proposal

The proposal would permit disclosure of certain tax information with respect to applicants for, and participants in, certain HUD programs. Such disclosure could be made only to HUD employees for use solely in verifying the taxpayer's eligibility for (or correct amount of benefits under) those HUD programs. The information would, in general, be provided by means of low-cost computer exchanges of information. The proposal would extend the present-law restrictions on unauthorized disclosure to HUD and its employees. HUD employees would not be allowed to redisclose tax information to State or local housing agencies, public housing authorities, or any other third party. However, they would be allowed to inform such parties of the fact that a discrepancy exists between the information provided by the applicant (or participant) and information provided by other sources.

The proposal would require the Treasury Department, in consultation with HUD, to conduct a study to determine (1) whether the tax return information disclosed to HUD was being used effectively, (2) whether HUD was complying with the Code's safeguards against unauthorized disclosure of the information, and (3) the impact on the privacy rights of applicants and participants

in HUD housing programs. The study would be required to be submitted to the tax-writing committees before January 1, 1998.

Effective Date

The proposal would be effective on the date of enactment. The authority to disclose tax information to HUD under the proposal would expire after September 30, 1998.