JOINT COMMITTEE ON TAXATION
June 10, 2004
JCX-42-04

DESCRIPTION OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO THE PROVISIONS OF H.R. 4520, THE "AMERICAN JOBS CREATION ACT OF 2004"

A. Modifications

The Chairman's amendment in the nature of a substitute to the provisions of H.R. 4520 makes the following modifications to the introduced bill, H.R. 4520, the "American Jobs Creation Act of 2004":

1. Suspension of occupational taxes relating to distilled spirits, wine, and beer

The amendment clarifies that, during the period in which the occupational taxes are suspended, as under present law, a limited retail dealer in liquors (such as a charitable organization selling liquor at a picnic) may lawfully purchase distilled spirits for resale from a retail dealer in distilled spirits, as allowed under present law.

2. Taxation of certain settlement funds

The amendment clarifies the original intent that, upon termination, any funds remaining in the settlement fund are to be disbursed to the Government or an agency or instrumentality thereof.

3. Extension of the research credit

The amendment provides that the proposal extending the research credit is effective for expenditures paid or incurred after June 30, 2004.

4. Extension and modification of the section 45 electricity production credit

The amendment provides that the proposal extending and modifying the electricity production credit is effective for facilities placed in service after December 31, 2003.

5. Extension of Archer Medical Savings Accounts ("MSAs")

The amendment extends Archer MSAs for one additional year (through December 31, 2005).

6. Extension of the authority to issue Liberty Zone Bonds

The amendment extends authority to issue New York Liberty Bonds for one additional year (through December 31, 2009).

7. Limitation on deductions allocable to property used by governments or other tax-exempt entities

The amendment provides that, if a taxpayer enters into a lease of tax-exempt use property and the lease has a term of five years or less, the taxpayer is not required to make a minimum initial equity investment in the property for purposes of the substantial equity investment requirement. Thus, a lease of tax-exempt use property with a lease term of five years or less is not required to satisfy the substantial equity investment requirement or minimal lessee risk of loss requirement, but is required to satisfy the availability of funds requirement, in order to avoid the disallowance of tax-exempt use losses under the provision.

8. Safe harbor for churches

The amendment omits the separate statutory requirements with regard to filing a tax return for organizations subject to the tax on impermissible activities. Instead, the filing of a return to pay such tax is required pursuant to the present-law provisions of section 6011. Accordingly, the present-law penalties that generally are applicable with respect to returns required to be filed pursuant to section 6011 also will be applicable to returns with respect to the tax imposed by the bill. For example, the present-law penalties for failure to file a return or failure to pay the tax (sec. 6651), the accuracy-related penalty (sec. 6662), the fraud penalty (sec. 6663), and the criminal penalties (such as for willful failure to file a return (sec. 7203)) are all automatically applicable because the filing of a return to pay the tax imposed by the bill is required pursuant to the provisions of section 6011.

The amendment clarifies that the tax on impermissible activities is based not only on an organization's gross income but also on an organization's contributions and gifts.

9. Clerical amendments

The amendment makes clerical and typographical amendments to H.R. 4520.

B. Other Provisions

The Chairman's amendment in the nature of a substitute to the provisions of H.R. 4520, the "American Jobs Creation Act of 2004" also adds the following provisions.

1. Exclusion of certain indebtedness of small business investment companies from acquisition indebtedness

Present Law

In general, 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. Certain types of income, such as rents, royalties, dividends, and interest, generally are excluded from unrelated business taxable income except when such income is derived from "debt-financed property." Debt-financed property generally means any property that is held to produce income and with respect to which there is acquisition indebtedness at any time during the taxable year.

In general, income of a tax-exempt organization that is produced by debt-financed property is treated as unrelated business income in proportion to the acquisition indebtedness on the income-producing property. Acquisition indebtedness generally means the amount of unpaid indebtedness incurred by an organization to acquire or improve the property and indebtedness that would not have been incurred but for the acquisition or improvement of the property.[1] Acquisition indebtedness does not include: (1) certain indebtedness incurred in the performance or exercise of a purpose or function constituting the basis of the organization's exemption; (2) obligations to pay certain types of annuities; (3) an obligation, to the extent it is insured by the Federal Housing Administration, to finance the purchase, rehabilitation, or construction of housing for low and moderate income persons; or (4) indebtedness incurred by certain qualified organizations to acquire or improve real property. An extension, renewal, or refinancing of an obligation evidencing a pre-existing indebtedness is not treated as the creation of a new indebtedness.

Description of Proposal

The proposal modifies the debt-financed property provisions by excluding from the definition of acquisition indebtedness any indebtedness incurred by a small business investment company licensed under the Small Business Investment Act of 1958 that is evidenced by a debenture (1) issued by such company under section 303(a) of said Act, and (2) held or guaranteed by the Small Business Administration. The exclusion shall not apply during any period that any exempt organization (other than a governmental unit) owns more than 25 percent of the capital or profits interest in the small business investment company, or exempt organizations (including governmental units other than any agency or instrumentality of the

[1] Special rules apply in the case of an exempt organization that owns a partnership interest in a partnership that holds debt-financed income-producing property. An exempt organization's share of partnership income that is derived from such debt-financed property generally is taxed as debt-financed income unless an exception provides otherwise.

United States) own, in the aggregate, 50 percent or more of the capital or profits interest in such company.

Effective Date

The proposal is effective for small business investment companies formed after the date of enactment.

2. Election to determine taxable income from certain international shipping activities using per-ton rate

Present Law

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, including income from shipping operations, whether derived in the United States or abroad. In order to mitigate the double taxation that may arise from taxing the foreign-source income of a domestic corporation, a foreign tax credit for income taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Generally, the United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income, including shipping income, which is "effectively connected" with the conduct of a trade or business in the United States (sec. 882). Such "effectively connected income" generally is taxed in the same manner and at the same rates as the income of a U.S. corporation. An applicable tax treaty may limit the imposition of U.S. tax on business operations of a foreign corporation to cases in which the business is conducted through a "permanent establishment" in the United States.

The United States also imposes a four percent tax on the amount of a foreign corporation's U.S. gross transportation income (sec. 887). Transportation income includes income from the use, hiring, or leasing of a vessel and income from services directly related to the use of a vessel. The portion of this income that is considered to be U.S. source, and thus U.S. gross transportation income, is fifty percent of the income from transportation that begins or ends (but not both) in the United States. The tax does not apply, however, to U.S. gross transportation income that is treated as income effectively connected with the conduct of a U.S. trade or business. U.S. gross transportation income is treated as effectively connected income if (1) the taxpayer has a fixed place of business in the United States involved in earning the income, and (2) substantially all the income is attributable to regularly scheduled transportation.

Under present law, there is no provision that provides an alternative to the corporate income tax for taxable income attributable to international shipping activities.

Description of Proposal

In general

The proposal allows certain ship operators to elect a "tonnage tax" in lieu of the U.S. corporate income tax on their taxable income from qualifying shipping activities. Under the tonnage tax regime, taxable income from qualifying shipping activities that would otherwise be taxable under sections 11, 55, 882, 887 or 1201(a) is only subject to tax at the maximum rate applicable under section 11(b). However, a foreign corporation is not subject to tax under the tonnage tax regime to the extent its income from qualifying shipping activities is subject to an exclusion for certain ships operated by foreign corporations pursuant to section 883(a)(1) or pursuant to a treaty obligation of the United States.

Taxable income from qualifying shipping activities

Generally, the taxable income of an electing corporation from qualifying shipping activities is the corporate income percentage[2] of the sum of the taxable income from each of its qualifying vessels. The taxable income from each qualifying vessel is the product of (1) the daily notional taxable income[3] from the operation of the qualifying vessel in United States foreign trade,[4] and (2) the number of days during the taxable year that the electing entity operated such vessel as a qualifying vessel in U.S. foreign trade.[5] A "qualifying vessel" is described as a self-propelled U.S. flagged vessel of not less than 10,000 deadweight tons used in U.S. foreign trade.

An entity's qualifying shipping activities consist of its (1) core qualifying activities, (2) qualifying secondary activities, and (3) qualifying incidental activities. Generally, core

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[2] The "corporate income percentage" is the least aggregate share of any item of income or gain of an electing corporation, or an electing group (i.e., a controlled group of which one or more members is an electing entity) of which such corporation is a member from qualifying shipping activities that would otherwise be required to be reported as on the U.S. Federal income tax return of an electing corporation during any taxable period.

[3] The "daily notional taxable income" from the operation of a qualifying vessel is 40 cents for each 100 tons of the net tonnage of the vessel (up to 25,000 net tons), and 20 cents for each 100 tons of the net tonnage of the vessel, in excess of 25,000 net tons.

[4] "U.S. foreign trade" means the transportation of goods or passengers between a place in the United States and a foreign place or between foreign places. As a general rule, the temporary operation in the U.S. domestic trade (i.e., the transportation of goods or passengers between places in the United States) of any qualifying vessel is disregarded. However, a vessel that is no longer used for operations in U.S. foreign trade (unless such non-use is on a temporary basis) ceases to be a qualifying vessel when such non-use begins.

[5] If there are multiple operators of a vessel, the taxable income of such vessel must be allocated among such persons on the basis of their ownership and charter interests or another basis that Treasury may prescribe in regulations.

qualifying activities are activities from operating vessels in U.S. foreign trade and other activities of an electing entity and an electing group that are an integral part of the business of operating qualifying vessels. Qualifying secondary activities generally consist of the active management or operation of vessels in U.S. foreign trade and provisions for vessel, container and cargo-related facilities or such other activities as may be prescribed by the Secretary (which are not core activities), and may not exceed 20 percent of the aggregate gross income derived from electing entities and other members of its electing group from their core qualifying activities. Qualifying incidental activities are activities incidental to core qualifying activities, and which are not qualifying secondary activities. The aggregate gross income from qualifying incidental activities cannot exceed one-tenth of one percent of the aggregate gross income from the core qualifying activities of the electing entities and other members of its electing group.

Items not subject to corporate income tax

Generally, gross income from an electing entity does not include the corporate income percentage of entity's (1) income from qualifying shipping activities in U.S. foreign trade, (2) income from money, bank deposits and other temporary investments which are reasonably necessary to meet the working capital requirements of its qualifying shipping activities, and (3) income from money or other intangible assets accumulated pursuant to a plan to purchase qualifying shipping assets.[6] Generally, the corporate loss percentage[7] of each item of loss, deduction, or credit is disallowed with respect to any activity the income from which is excluded from gross income under the proposal is disallowed. The corporate loss percentage of an electing entity's interest expense is disallowed in the ratio that the fair market value of its qualifying shipping assets bears to the fair market value of its total assets.

Allocation of credits, income and deductions

No deductions are allowed against the taxable income of an electing corporation from qualifying shipping activities, and no credit is allowed against the tax imposed under the tonnage tax regime. No deduction is allowed for any net operating loss attributable to the qualifying shipping activities of a corporation to the extent that such loss is carried forward by the corporation from a taxable year preceding the first taxable year for which such corporation was an electing corporation. For purposes of the proposal, section 482 applies to a transaction or series of transactions between an electing entity and another person or between an entity's qualifying shipping activities and other activities carried on by it. The qualifying shipping activities of an electing entity shall be treated as a separate trade or business activity from all other activities conducted by the entity.

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[6] "Qualifying shipping assets" means any qualifying vessel and other assets which are used in core qualifying activities.

[7] "Corporate loss percentage" means the greatest aggregate share, expressed as a percentage, of any item of loss, deduction or credit of an electing corporation or electing group of which such corporation is a member from qualifying shipping activities that would otherwise be required to be reported on the U.S. Federal income tax return of an electing corporation during any taxable period.

Qualifying shipping assets

If an electing entity sells or disposes of qualifying shipping assets in an otherwise taxable transaction, at the election of the entity no gain is recognized if replacement qualifying shipping assets are acquired during a limited replacement period except to the extent that the amount realized upon such sale or disposition exceeds the cost of the replacement qualifying shipping assets. If an entity elects not to recognize gain, the period for the assessment of any deficiency for any taxable year in which any part of the gain is realized shall not expire prior to three taxable years from the date the Secretary is notified by the entity of the replacement tonnage tax property or of an intention not to replace. Such deficiency may be assessed before the expiration of the three-year period notwithstanding the provisions of section 6212(c) or the provisions of any other law or rule of law which would otherwise prevent such assessment.

In the case of replacement qualifying shipping assets purchased by an electing entity which results in the nonrecognition of any part of the gain realized as the result of a sale or other disposition of qualifying shipping assets, the basis is the cost of such property decreased in the amount of gain not recognized; and if the property purchased consists of more than one piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

The election not to recognize gain on the disposition and replacement of qualifying shipping assets is not available if the replacement qualifying shipping assets are acquired from a related person except to the extent that the related person (as defined under section 267(b) or 707(b)(1)) acquired the replacement qualifying shipping assets from an unrelated person during a limited replacement period.

Election

Generally, any qualifying entity may elect into the tonnage tax regime by filing an election with the qualifying entity's income tax return for the first taxable year to which the election applies. However, a qualified entity, which is a member of a controlled group,[8] may only make an election into the tonnage tax regime if all qualifying entities that are members of the controlled group make such an election. Once made, an election is effective for the taxable year in which it was made and for all succeeding taxable years of the entity until it is terminated. An election may be terminated if the entity ceases to be a qualifying entity or if the election is revoked. In the event that a qualifying entity elects into the tonnage tax regime and subsequently revokes the election, such entity is barred from electing back into the regime until the fifth taxable year after the termination is effective.

[8] The term "controlled group" refers to any group of trusts and business entities whose members would be treated as a single employer under the rules of section 52(a) (without regard to paragraphs (1) and (2)) and section 52(b)(1)).

A qualifying entity means a trust or business entity that (1) operates one or more qualifying vessels and (2) meets the "shipping activity requirement."[9] The shipping activity requirement is met for a taxable year only by an entity that meets one of the following requirements: (1) in the first taxable year of its election in to the tonnage tax regime, for the preceding taxable year on average at least 25 percent of the aggregate tonnage of the qualifying vessels which were operated by the entity were owned by the entity or bareboat chartered to the entity; (2) in the second or any subsequent taxable year of its election in to the tonnage tax regime, in each of the two preceding taxable years on average at least 25 percent of the aggregate tonnage of the qualifying vessels which were operated by the entity were owned by the entity or bareboat chartered to the entity; or (3) requirements (1) or (2) above would be met if the 25 percent average tonnage requirement was applied on an aggregate basis to the controlled group of which such entity is a member, and vessel charters between members of the controlled group were disregarded.

Effective Date

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

3. Charitable contribution deduction for certain expenses in support of native Alaskan subsistence whaling

Present Law

In computing taxable income, individuals who do not elect the standard deduction may claim itemized deductions, including a deduction (subject to certain limitations) for charitable contributions or gifts made during the taxable year to a qualified charitable organization or governmental entity. Individuals who elect the standard deduction may not claim a deduction for charitable contributions made during the taxable year.

No charitable contribution deduction is allowed for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization, contributions to which are deductible, may constitute a deductible contribution.[10] Specifically, section 170(j) provides that no charitable contribution deduction is allowed for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

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[9] An entity is generally treated as operating any vessel owned by or chartered to the entity. However, an entity is treated as operating a vessel that it has chartered out on bareboat basis only if: (1) the vessel is temporarily surplus to the entity's requirements and the term of the charter does not exceed three years or (2) the vessel is bareboat chartered to a member of a controlled group which includes such entity or to an unrelated third party that sub-bareboats or time charters the vessel to a member of such controlled group (including the owner). Special rules apply in an instance in which an electing entity temporarily ceases to operate a qualifying vessel.

[10] Treas. Reg. sec. 1.170A-1(g).

Description of Proposal

The proposal allows individuals to claim a deduction under section 170 not exceeding $10,000 per taxable year for certain expenses incurred in carrying out sanctioned whaling activities. The deduction is available only to an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities. The deduction is available for reasonable and necessary expenses paid by the taxpayer during the taxable year for: (1) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities; (2) the supplying of food for the crew and other provisions for carrying out such activities; and (3) the storage and distribution of the catch from such activities. It is intended that the Secretary shall require that the taxpayer substantiate deductible expenses by maintaining appropriate written records that show, for example, the time, place, date, amount, and nature of the expense, as well as the taxpayer's eligibility for the deduction, and that such substantiation be provided as part of the taxpayer's income tax return, to the extent provided by the Secretary.

For purposes of the provision, the term "sanctioned whaling activities" means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission.

Effective Date

The proposal is effective for contributions made after December 31, 2004.

4. Suspension of duties on ceiling fans

Present Law

A 4.7-percent *ad valorem* customs duty is collected on imported ceiling fans from all sources.

Description of Proposal

The proposal suspends the present customs duty applicable to ceiling fans through December 31, 2006.

Effective date

The proposal is effective on the fifteenth day after the date of enactment.

5. Suspension of duties on nuclear steam generators

Present Law

Nuclear steam generators, as classified under heading 9902.84.02 of the Harmonized Tariff Schedule of the United States, enter the United States duty free until December 31, 2006. After December 31, 2006, the duty on nuclear steam generators returns to the column 1 rate of

5.2 percent under subheading 8402.11.00 of the Harmonized Tariff Schedule of the United States.

Description of Proposal

The proposal extends the present-law suspension of customs duty applicable to nuclear steam generators through December 31, 2008.

Effective date

The proposal is effective on the date of enactment.

6. Suspension of duties on nuclear reactor vessel heads

Present Law

According to section 5202 of the Trade Act of 2002, nuclear reactor vessel heads are classified under subheading 8401.40.00 of the Harmonized Tariff Schedule of the United States and enter the United States with a column 1 duty rate of 3.3 percent.

Description of Proposal

The proposal temporarily suspends the present-law customs duty applicable to nuclear reactor vessel heads for column 1 countries through December 31, 2008.

Effective Date

The proposal is effective on the fifteenth day after the date of enactment.