MEMORANDUM

From: Finance Committee Staff

Date: May 12, 2004

Re: Grassley-Baucus Manager Amendment Changes to the FSC Bill on May 11, 2004

This memo describes changes made on May 11, 2004, to S. 1637 after the second complete substitute of the bill was filed in April 2004. In addition to the provisions described below, staff made a number of technical and conforming changes. The bill remains fully offset.

Senate Amendment Number 3133

- **Section 163(j) Deductibility of Arm's length borrowing costs.** Under current law, if the U.S. subsidiary of a foreign parent corporation borrows money from an unrelated party and the foreign parent .corporation guarantees the indebtedness, the subsidiary's overall debt levels are closely scrutinized and the interest deduction on its borrowing may be limited. This provision provides a limited carve-out for any U.S. subsidiary that proves it could have borrowed the money without its parent corporation's guarantee.

- **Private Debt Collection**. Amends the provision to require (i) that all service contracts expire within five years of the date of enactment, (ii) a biennial report to Congress which includes a complete cost benefit analysis, impact on collection enforcement staff levels; dollars collected, cost incurred (indirect and direct), evaluations of contractor performance, 6103 disclosure safeguard report, and a measurement plan, and (iii) that an amount not in excess of 25% of the private debt collector collections be used for purposes of increased IRS enforcement.

- **Section 501(c)(15)**. Under current law, a property and casualty insurance company is eligible to be exempt from Federal income tax if (a) its gross receipts for the taxable year do not exceed $600,000, and (b) the premiums received for the taxable year are greater than 50 percent of its gross receipts. The provision increases the 50 percent of gross receipts threshold to 60 percent of gross receipts. Also under current law, a property and casualty insurance company may elect to be taxed only on taxable investment income if its written premiums do not exceed $1.2 million. The provision increases the $1.2 million limit to $1.89 million and indexes it for inflation after 2005.

- **Intellectual Property and Patents Donation Modification.** The proposal modifies the donation of intellectual property and patents provision in the underlying bill, so that a donor is able to claim the lesser of $1 million or 5% of fair market value for donations of intellectual property or patents in the year the contribution is made. In subsequent years donors would be able to deduct additional contribution amounts based on a percentage of income received by the donee. Originally, the proposal limited a donor's deduction to basis. The proposal also directs the IRS to develop appraisal standards and requires donors to pay a processing fee equal to 1% of the deduction.

- **Rehabilitation Tax Credit**. Strikes the provision in the bill that repeals the 10% rehabilitation tax credit.

- **Captioning Credit.** The provision provides a 50% tax credit to businesses for costs incurred in captioning movies in order to make them accessible to the deaf and hard of hearing. The credit may be provided to producers or distributors of movies, as well as those in the business of showing movies (movie theaters).

- **Civil Rights Tax Fairness**. Proposal expands the Civil Rights Tax Fairness Act to ensure that attorneys fees related to suits under the Medicare as Secondary Payer statute (42 U.S.C. §1395y(b)(3)(A)) are deductible for purposes of computing gross income.

- **Below Market Interest on Loans**. Repeals the application of the below-market loan rules to loans that are made to any qualified continuing care facility pursuant to a continuing care contract. The provision also clarifies that the determination of whether a facility is a qualified continuing care facility is to be made on an annual basis. The provision would also provide Treasury with authority to issue limiting guidance on the definition of continuing care contracts.

- **Section 6404(g)**. Repeals the suspension on the accrual of interest normally effective 18 months after filing and lasting until notice of assessment for certain tax-motivated transactions that are determined to be (i) listed transactions or (ii) reportable avoidance transactions, as those terms are defined for purposes of the tax shelter legislation included in the underlying bill.

- **TVA**. The amendment clarifies that TVA is included in the class of tradeable credits in both section 45 and clean coal.

- **Credit for Qualifying Pollution Control Equipment.** This amendment allows a qualifying ethanol facility to claim an investment credit equal to 15% of basis of qualifying pollution control equipment. Among other things, pollution control equipment means technology installed to reduce air emissions regulated by the EPA to include thermal oxidizers, regenerative thermal oxidizers, scrubbers systems, evaporative control systems and vapor recovery systems.

<u>**Senate Amendment Number 3143**</u>

- **Films modifications.** Currently the bill provides that the manufacturing deduction with respect to films is to be calculated on a “product line-by-product line” basis. The amendment clarifies the rules for determining the manufacturing deduction on this basis. In addition, the bill makes two changes to the manufacturing deduction with respect to films. Currently, the bill provides that manufacturing gross receipts are receipts from the sale, exchange, disposition, lease, rental, or license of domestically manufactured property. The amendment adds to this definition receipts from the "use of" manufactured property with respect to films. Films subject to this "use of" clause are also excluded from the definition of topical or transitory property (which is generally not eligible for the manufacturing deduction).

- **Green Bonds.** The amendment modifies the building rating system in the Green Bonds proposal by revising the criteria used to award LEED certification points for the use of wood products, renewable wood products, and composite wood products. Specifically, points are awarded for wood products certified under the Sustainable Forestry Initiative Program and the American Tree Farm System, renewable wood products credited for LEED certification recycled content, and composite wood products certified under standards established by the American National Standards Institute or such other voluntary standards as published in the Federal Register by the Administrator of the Environmental Protection Agency.

- **Virgin Islands revenue raiser.** The Allard green bonds amendment included a revenue raiser requiring U.S. citizens who become Virgin Islands residents to file information returns with the IRS for two years after they became Virgin Islands residents. It also strengthened the test for determining residency. This amendment alters the information filing aspect of the provision, requiring Virgin Islands residents to file U.S. information returns indefinitely.

- **AMT Relief.** The provision allows taxpayers to increase their alternative minimum tax credit in lieu of claiming bonus depreciation. Certain taxpayers that are making extensive capital investments are not subject to regular income tax because of continuing net operating losses. These same taxpayers may be subject alternative minimum tax (AMT). AMT can be caused by depreciation claimed on new asset acquisitions. This provision allows taxpayers to increase their AMT limitation on credit for prior year minimum tax liabilities in lieu of claiming bonus depreciation. The present provision is capped for bonus depreciation up to $10 million. This provision increases the depreciation cap to $25 million.

- **Precious Metals.** Under current law, the net capital gain income attributable to the sale or exchange of collectibles is taxed at a maximum rate of 28 percent. The definition of collectibles includes any metal or coin. The amendment would remove gold, silver, platinum and palladium coin or bullion from the list of collectible items for cap gains. This would allow these precious metals to be taxed at the preferential maximum capital gain tax rates.

- **Sickle Cell.** The provision adds as an optional benefit to the Medicaid program primary and secondary medical strategies and treatment for individuals with sickle cell disease.

- **Contract Manufacturing.** Under current law, deferral of taxation is allowed for active offshore business activities. If, however, the offshore activity involves the purchase and resale of goods to or on behalf of a related party, then the foreign income is taxed currently. The issue presented is whether manufacturing conducted on behalf of a foreign subsidiary of a U.S. corporation constitutes an active business activity. The provision in the bill codifies a view announced by the IRS in 1997. Because the IRS position is under review and may not be sustained under current case law, this change accepts Sen. Kyl's amendment to strike the contract manufacturing provision in the underlying bill.

- **Buy America.** The proposal requires a report from the head of each executive agency to report on the articles purchase by those agencies which are manufactured outside the United States. The Commerce Department will report on the articles purchased by foreign governments which are made in the United States.