H.R. 3970
Tax Reduction and Reform Act of 2007

October 29, 2007

I. INDIVIDUAL TAX RELIEF

The combination of the general tax reductions below and full repeal of the individual alternative minimum tax (AMT) would result in tax relief for approximately 91 million families. Even with offsets, virtually all families with income under $500,000 will see a net tax reduction.

GENERAL TAX REDUCTIONS

Increase in standard deduction. The bill would permanently increase the standard deduction. Married couples filing jointly would be entitled to take an additional $850 as a standard deduction. Individuals (single and married filing separately) would be entitled to take an addition $425 as a standard deduction and heads of household would be entitled to take an additional $625 as a standard deduction. These amounts will be adjusted for inflation in the future. *This proposal is estimated to cost $47.92 billion over 10 years.*

Modification of earned income credit amount for individuals with no qualifying children. The bill would expand the number of taxpayers that can qualify for the earned income credit. The bill would increase the earned income credit percentage and phase-out percentage for individuals with no qualifying children. In general, current law provides that individuals with no qualifying children are allowed to take an earned income credit equal to 7.65% of their earned income. The amount of this credit is currently subject to an overall limitation that is calculated using a phase-out amount of $5,280. The bill would increase the credit percentage and phase-out percentage to 15.3% of earned income and would increase the phase-out amount to $10,900 (increased in the future for inflation). *This proposal is estimated to cost $29.14 billion over 10 years.*

Change in refundable child credit. The bill would increase the amount of the refundable child tax that may be claimed. The child tax credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of approximately $11,000 as a result of inflation adjustments to the original floor of $10,000. The bill would eliminate this inflation adjustment and freeze the floor at $8,500. *This proposal is estimated to cost $9.12 billion over 10 years.*

2007 AMT RELIEF

Extension of AMT relief for 2007. The bill would extend for one year AMT relief for nonrefundable personal credits and the 2006 increased AMT exemption amount (indexed for inflation). *This proposal is estimated to cost $49.6 billion over 10 years.*

PERMANENT REPEAL OF THE INDIVIDUAL AMT

Repeal of alternative minimum tax on individuals. The bill would repeal the alternative minimum tax on individuals for taxable years beginning after 2007. *This proposal is estimated to cost $795.66 billion over 10 years.*

Limitation of benefits of individual AMT repeal. For taxable years beginning after 2007, the bill would limit the benefits of repealing the individual alternative minimum tax for taxpayers earning above an amount to be set by the Secretary of the Treasury. The amount to be set by the Treasury shall be determined by selecting an income level above which ninety percent of all married taxpayers would otherwise be subject to tax under the AMT, but in no event less than $200,000. These taxpayers will pay a replacement tax of 4% on income in excess of this specified amount and 4.6% on income in excess of $500,000 ($250,000 in the case of single taxpayers). *This proposal is estimated to raise $831.70 billion over 10 years.*

High income individuals subject to overall limitation on itemized deductions and phaseout of deductions for personal exemptions. For taxable years beginning after 2007, the bill would restore the overall limitation on itemized deductions and the phase-out of the deduction for personal exemptions to the same limitation that existed before the enactment of the "Economic Growth and Tax Relief Reconciliation Act of 2001" ("EGTRRA") for taxpayers with adjusted gross income in excess of $250,000 ($500,000 in the case of a joint return). For taxpayers with adjusted gross income between $250,000 and $270,000 ($500,000 and $520,000 in the case of a joint return) the difference between the present-law limitations and the complete restoration of these limitations would be phased in. *This proposal is estimated to raise $28.58 billion over 10 years.*

Modification of 2-percent floor on miscellaneous itemized deductions. For taxable years beginning after 2007, the bill would modify the two-percent floor on miscellaneous itemized deductions for taxpayers with adjusted gross income greater than or equal to the threshold set by the Secretary of the Treasury in determining which taxpayers will be affected by the limitation if benefits of repealing the individual AMT. These taxpayers would be allowed to take a deduction for miscellaneous itemized expenses in any taxable year to the extent that these deductions exceed two percent of the taxpayer's adjusted gross income up to this threshold plus five percent of the taxpayer's adjusted gross income in excess of this threshold. This rule is more favorable than the current-law AMT, which generally does not allow taxpayers to claim any miscellaneous deductions. *This proposal is estimated to raise $7.13 billion over 10 years.*

II. OTHER INDIVIDUAL TAX REFORMS

Taxation of carried interest as ordinary income. The bill would prevent investment fund managers from paying taxes at capital gains rates on investment management services income received as carried interest in an investment fund. The bill would require such managers to treat carried interest as ordinary income received in exchange for the performance of services to the extent that carried interest does not reflect a reasonable return on invested capital. The bill would continue to tax carried interest at capital gain tax rates to the extent that carried interest reflects a reasonable return on invested capital. *This proposal is estimated to raise $25.66 billion over 10 years.*

Current inclusion of deferred compensation paid by offshore hedge funds to investment managers. The bill would prevent hedge fund managers from using offshore tax haven corporations and other structures to defer taxes on compensation received for providing investment services. Under the bill, such managers would be required to take this deferred compensation into account as it accrues. Current law generally allows executives and other employees to defer paying tax on compensation until the compensation is paid. This deferral is made possible by rules that require the corporation paying the deferred compensation to defer the deduction that relates to this compensation until the compensation is paid. Matching the timing of the deduction with the income inclusion ensures that the executive is not able to achieve the tax benefits of deferred compensation at the expense of the Treasury. Instead, the corporation paying the compensation bears the expense of paying deferred compensation as a result of the deferred deduction. Where a hedge fund manager is paid deferred compensation by an offshore tax haven corporation or by a partnership that has mainly tax-exempt entities as investors, there is no offsetting deduction that can be deferred. As a result, hedge fund managers are able to achieve the tax benefits of deferred compensation at the expense of the Treasury. *This proposal is estimated to raise $22.64 billion over 10 years.*

Modification of unrelated business income tax rules for certain investment partnerships. The bill would allow pension plans, universities and other tax-exempt entities to directly invest in hedge funds and other investment funds without incurring unrelated business income tax ("UBIT"). This would eliminate the current-law incentive for pension plans, universities and other tax exempt entities to invest in hedge funds and other investment funds through offshore "blocker" corporations formed in tax haven jurisdictions and would improve the investment returns for pension plans, universities and other tax exempt entities that invest in these investment funds. *This proposal is estimated to cost $1.34 billion over 10 years.*

Treatment of certain gain on sales between related persons as ordinary income as a result of tax sharing agreements. Under current law, if a taxpayer sells depreciable property to a related person, any gain recognized on that transfer will be ordinary income. The bill would treat taxpayers as being related if there is an agreement (e.g., a tax sharing agreement) between the parties that provides for the payment to the transferor of any amount which is determined by reference to the tax benefit realized by the transferee as a result of depreciating the property transferred. *This proposal is estimated to raise $135 million over 10 years.*

Clarification of shareholder-employees of service S corporations and partner-employees of service partnerships liability for self-employment taxes. The bill would conform the self-employment tax treatment of shareholder-employees of S corporations that are engaged in service businesses with the tax treatment of other service providers. These shareholder-employees would be subject to self-employment taxes on the portion of their S corporation distributive share that relates to the service business of the S corporation. The bill would also make conforming changes to the self-employment tax treatment of limited partner-employees of service partnerships that are engaged in service businesses. *This proposal is estimated to raise $9.41 billion over ten years*.

Basis reporting by brokers on sales of stock. The bill creates mandatory cost basis reporting by brokers for transactions involving publicly traded securities. Covered securities are generally stock, debt, commodities, derivatives and other items as specified by the Treasury Secretary, which are acquired in the account or transferred to the account managed by the broker. The provision applies to stock acquired after January 1, 2009 and after January 1, 2011 for all other instruments. *This proposal is estimated to raise $4.27 billion over 10 years.*

III. ONE-YEAR EXTENDERS

Extension of R&D credit. The bill extends the research credit for one year. *This proposal is estimated to cost $9 billion over 10 years.*

Extension of Indian employment credit. The bill extends for one year the business tax credit for employers of qualified employees that work and live on or near an Indian reservation. The credit is for wages and health insurance costs paid to qualified employees (up to $20,000) in the current year over the amount paid in 1993. Wages for which the work opportunity tax credit is available are not qualified wages for the Indian employment tax credit. *This proposal is estimated to cost $59 million over 10 years.*

Extension of new markets tax credit. The bill extends the current-law new markets tax credit for one additional year (through the end of 2009), permitting a $3.5 billion maximum annual amount of qualified equity investments. *This proposal is estimated to cost $1.32 billion over 10 years.*

Extension of railroad track maintenance credit. The bill extends the railroad track maintenance credit for one year. The railroad track maintenance credit provides Class II and Class III railroads (e.g., short-line railroads) with a tax credit equal to 50 percent of gross expenditures for maintaining railroad tracks that they own or lease. *This proposal is estimated to cost $165 million over 10 years.*

Extension of the deduction for mortgage insurance. The bill extends the deduction for mortgage insurance payments (including Veterans Administration, Rural Housing Administration, and Federal Housing Administration insurance premiums) for one year. *This proposal is estimated to cost $17 million over 10 years.*

Extension of the deduction of State and local general sales taxes. The bill extends for one year the election to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction permitted for State and local income taxes. *This proposal is estimated to cost $3.58 billion over 10 years.*

Extension of 15-year straight-line cost recovery for qualified leasehold improvements and qualified restaurant improvements. The bill would extend for one year the special 15-year cost recovery period for certain leasehold and qualified restaurant improvements. Absent an extension of this provision, the cost recovery period for these facilities would be 39 years. *This proposal is estimated to cost $3.47 billion over 10 years.*

Extension of 7-year straight-line cost recovery period for motorsports entertainment complexes. The bill would extend for one year the special 7-year cost recovery period for property used for land improvement and support facilities at motorspotrs entertainment complexes. Absent an extension of this provision, the cost recovery period for these facilities would be 15 years. *This proposal is estimated to cost $27 million over 10 years.*

Extension of accelerated depreciation for business property on an Indian reservation. The bill extends the placed-in-service date by one year for the special depreciation recovery period for qualified Indian reservation property. In general, qualified Indian reservation property is property used predominantly in the active conduct of a trade or business within an Indian reservation, which is not used outside the reservation on a regular basis and was not acquired from a related person. *This proposal is estimated to cost $148 million over 10 years.*

Extension of expensing of "brownfields" environmental remediation costs. The bill would extend for one year the provision that allows for the expensing of costs associated with cleaning up hazardous ("brownfield") sites. *This proposal is estimated to cost $192 million over 10 years.*

Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico. The bill would extend for one year the provision extending the section 199 domestic production activities deduction to activities in Puerto Rico. *This proposal is estimated to cost $116 million over 10 years.*

Extension of above-the-line deduction for qualified tuition and related expenses. The bill extends the current-law above-the-line tax deduction for qualified education expenses for one year. For tax year 2007, the maximum deduction was $4,000 for taxpayers with AGI of $65,000 or less ($130,000 for joint returns) or $2,000 for taxpayers with AGI of $80,000 or less ($160,000 for joint returns). *This proposal is estimated to cost $1.39 billion over 10 years.*

Extension of special tax treatment of certain payments to controlling exempt organizations. The bill would extend for one year the current law special rules for interest, rents, royalties and annuities received by a tax exempt entity from a controlled entity. *This proposal is estimated to cost $23 million over 10 years.*

Extension of special rules for regulated investment companies. The bill would for one year extend the current-law tax treatment of interest-related dividends, short-term capital gain dividends, and other special rules applicable to foreign shareholders that invest in regulated investment companies. *This proposal is estimated to cost $67 million over 10 years.*

Reauthorzation of qualified zone academy bonds (QZABs). The bill allows an additional $400,000,000 of QZAB issuing authority to State and local governments, which can be used to finance renovations, equipment purchases, developing course material, and training teachers and personnel at a qualified zone academy. In general, a qualified zone academy is any public school (or academic program within a public school) below college level that is located in an empowerment zone or enterprise community and is designed to cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates. QZABs are a form of tax credit bonds which offer the holder a federal tax credit instead of interest. The bill would improve the marketability of these bonds by modifying the current-law arbitrage restrictions. *This proposal is estimated to cost $156 million over 10 years.*

Extension of tax incentives for investment in the District of Columbia. The bill extends the designation of certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone. Businesses and individual residents within this enterprise zone are eligible for special tax incentives. The bill would also extend for one year the $5,000 first-time homebuyer credit for the District of Columbia. *This proposal is estimated to cost $158 million over 10 years.*

Extension of disclosures of certain tax return information. The bill would extend for one year the current-law authority for combined employment tax reporting and the current-law authority to disclose return information for purposes of the income-contingent loan repayment program. The bill would also extend for one year the present-law terrorist activity disclosure provisions. *These proposals are not estimated to have any revenue effect.*

Extension of authority for undercover operations. The bill extends for one year the current-law authorization for the IRS to engage in certain activities related to undercover operations, such as purchasing property, organizing business entities and use the proceeds from an undercover operation to pay additional expenses incurred in the undercover operation. *This proposal is estimated to have a negligible revenue effect.*

Extension of temporary increase in limit on cover over of run excise tax revenues to Puerto Rico and the Virgin islands. The bill extends for one year the current-law provision providing for payment of $13.25 per gallon to cover over a $13.50 per proof gallon excise tax on distilled spirits produced in or imported into the United States. *This proposal is estimated to cost $93 million over 10 years.*

Extension of tax on failure to comply with mental health parity requirements applicable to group health plans. The bill extends for one year a $100 per day excise tax on group health plans that impose limits on mental health benefits that are not imposed on medical and surgical benefits. *This proposal has not yet been estimated.*

Extension of American Samoa economic development credit. The bill extends for one year the American Samoa economic development credit. In general, this credit provides certain domestic corporations operating in American Samoa with a possessions tax credit to offset their U.S. tax liability on income earned in American Samoa from active business operations, sales of assets used in a business, or certain investments in American Samoa. *This proposal is estimated to cost $16 million over 10 years.*

Extension of provision encouraging contributions of capital gain real property made for conservation purposes. The bill would extend for one year the current-law increased contribution limits and carryforward period for amounts in excess of these limits for contributions of appreciated real property (including partial interests in real property) for conservation purposes. *This proposal is estimated to cost $52 million over 10 years.*

Extension of enhanced charitable deduction for contributions of food inventory. The bill would extend for one year the current-law provision allowing businesses to claim an enhanced deduction for the contribution of food inventory. *This proposal is estimated to cost $72 million over 10 years.*

Enhanced charitable deduction for contributions of book inventories to public schools. The bill would extend for one year the current-law provision allowing C corporations to claim an enhanced deduction for contributions of book inventory to public schools (kindergarten through grade 12). *This proposal is estimated to cost $31 million over 10 years.*

Extension of enhanced deduction for corporate contributions of computer equipment for educational purposes. The bill would extend for one year a provision that encourages businesses to contribute computer equipment and software to elementary, secondary, and post-secondary schools by allowing an enhanced deduction for such contributions. *This proposal is estimated to cost $218 million over 10 years.*

Extension of tax-free distributions from individual retirement plans for charitable purposes The bill would extend for one year the current-law provision that permits tax free charitable contributions from an Individual Retirement Account (IRA) of up to $100,000 per taxpayer, per taxable year. *This proposal is estimated to cost $452 million over 10 years.*

Extension of special rule for S corporations making charitable contributions of property. The bill would extend for one year the current-law provision allowing S corporation shareholders to take into account their pro rata share of charitable deductions even if such deductions would exceed such shareholder's adjusted basis in the S corporation. The bill would also make a technical correction clarifying the application of this provision. *This proposal is estimated to cost $54 million over 10 years.*

Extension of above-the-line deduction for certain expenses of elementary and secondary school teachers. The bill extends for one year the $250 above-the-line tax deduction for teachers and other school professionals for expenses paid or incurred for books, supplies (other than non-athletic supplies for courses of instruction in health or physical education, computer equipment (including related software and services), other equipment, and supplementary materials used by the educator in the classroom for one year (i.e., to expenses paid or incurred in taxable years beginning in 2008). *This proposal is estimated to cost $191 million over 10 years.*

Extension of election to include combat pay in earned income for purposes of the earned income credit. The bill extends for one year the special rules that allow members of the armed services to include their combat pay in their earned income in order to qualify for the earned income tax credit. *This proposal is estimated to cost $19 million over 10 years..*

Extension of special rules for qualified mortgage bonds for veterans. The bill extends for one year the special rules that allows veterans to qualify for State-operated, tax-exempt mortgage revenue bond programs to provide lower-income individuals with access to mortgages with lower interest costs without regard to first-time home buyer requirement. *This proposal is estimated to cost $159 million over 10 years.*

Extension of special rules for distributions from retirement plans to individuals called to active duty. The bill extends for one year special rules that permit active duty reservists to make penalty-free withdrawals from retirement plans. *This proposal has not yet been estimated.*

Extension certain look-through rules for non-residents investing in regulated investment companies. The bill extends for one year special look-through rules for non-residents that invest in regulated investment companies (RICs). *This proposal has not yet been estimated.*

IV. CORPORATE TAX REFORM

Reduction in corporate tax rate. The bill would reduce the top corporate marginal tax rate from 35% to 30.5%. *This proposal is estimated to cost $363.84 billion over 10 years.*

Repeal of domestic production activities deduction. The bill would repeal the section 199 domestic production activities deduction. When fully phased-in, this deduction is designed to provide qualifying taxpayers with a 3.15% rate reduction on domestic manufacturing income. Qualifying for this deduction is complicated, administratively burdensome and benefits only a narrow stream of corporate income. Eliminating this special deduction in favor of a general reduction in the corporate marginal tax rate would make the tax code simpler and would broadly benefit all corporations and all corporate activities. *This proposal is estimated to raise $114.93 billion over 10 years.*

Allocation of expenses and taxes on basis of repatriation of foreign income. Current law allows United States corporations to defer active business income that is earned through controlled foreign corporations. However, these corporations are allowed to take the deductions associated with this income into account on a current basis. This inconsistency encourages United States corporations to shift jobs overseas and to finance these overseas activities at the expense of taxpayers. The bill would require United States corporations that defer income through controlled foreign corporations to also defer the deductions that are associated with this income. These corporations will be able to recognize these deductions when they repatriate the deferred income back to the United States, which is when the deferred income is taxed. The revenue raised from modifying this aspect of current law will be invested into reducing the corporate marginal tax rate, which will encourage corporations to create jobs here in the United States. *This proposal is estimated to raise $106.39 billion over 10 years.*

Repeal of worldwide allocation of interest. The bill would repeal the current-law provision that allowed United States corporations to elect special interest allocation rules that reduce the amount of interest expense allocated to foreign assets. This provision was enacted in 2004 but it has yet to take effect. *This proposal is estimated to raise $26.20 billion over 10 years.*

Limitation on treaty benefit for certain deductible payments. The bill would prevent foreign multinational corporations incorporated in tax haven countries from avoiding tax on income earned in the United States by routing their income through structures in which a United States subsidiary of the foreign multinational corporation makes a deductible payment to a country with which the United States has a tax treaty before ultimately repatriating these earning in the tax haven country. This provision has been modified from a previous version approved by the House of Representatives as part of H.R. 2419, *The Farm, Nutrition and Bioenergy Act*, by a vote of 231 to 191 (with 19 Republicans joining 212 Democrats in support) to ensure that foreign multinational corporations incorporated in treaty partner countries will not be affected by this provision. *This proposal is estimated to raise approximately $6.40 billion over 10 years.*

Repeal of last-in, first-out (LIFO) accounting method with eight-year spread. The bill would repeal the last-in, first-out (LIFO) accounting method. Any income recognized as a result of this change in accounting method would be spread over eight years. *This proposal is estimated to raise $106.51 billion over 10 years.*

Repeal of lower of cost or market method. The bill would repeal the lower of cost or market method of valuing inventories. Current law generally allows taxpayers to choose between valuing inventories at cost or valuing inventories at the lower of cost and market. The bill would require taxpayers to value inventories at cost. Neither existing variations on the cost method (e.g., the retail method) nor the current-law treatment of subnormal goods would be affected by this provision. *This proposal is estimated to raise $7.15 billion over 10 years.*

Special rule for service providers on accrual method not applicable to C corporations. The bill would prevent C corporations from taking advantage of the special rule allowing accrual method taxpayers that perform certain services to not account for amounts which on the basis of such person's experience will not be collected. *This proposal is estimated to raise $225 million over 10 years.*

Permanent extension of enhanced small business expensing. Under current law, small business taxpayers are permitted to expense $125,000 (indexed for inflation), with a phase-out threshold of $500,000 (indexed for inflation). This enhanced small business expensing would expire in 2010. For years after 2010, small business taxpayers would only be allowed to expense $25,000 (not indexed for inflation), with a phase-out of $200,000 (also not indexed for inflation). The bill would permanently extend the enhanced small business expensing rules available under current law. *This proposal is estimated to cost $20.55 billion over 10 years.*

Modification to section 197 amortization period. The bill would increase the current 15-year amortization period for section 197 intangibles to 20 years. *This proposal is estimated to raise $20.70 billion over 10 years.*

Clarification of the economic substance doctrine. The bill would clarify the application of the economic substance doctrine but does not change current-law standards used by courts in determining when to utilize an economic substance analysis. Under the provision, in any case in which the economic substance doctrine is relevant to a transaction, the economic substance doctrine would be satisfied only if (1) the transaction changes in a meaningful way (apart from federal income tax consequences) the taxpayer's economic position, and (2) the taxpayer has a substantial non-federal tax purpose for entering into such transaction. The provision also imposes a 20% penalty on understatements attributable to a transaction lacking economic substance (penalty increased to 40% in the case of transactions in which the relevant facts affecting the tax treatment of the transaction are not adequately disclosed). *This proposal is estimated to raise $3.59 billion over 10 years.*

Modifications to deductions for dividends received. Consistent with past corporate marginal tax rate reductions, the bill would reduce the deduction for dividends received. In the case of 20-percent owned corporations, the current-law 80% dividends received deduction will be reduced to 70%. With respect to dividends that are currently eligible for a reduced 70% dividends received deduction, the bill would reduce this deduction to 60%. *This proposal is estimated to raise $4.60 billion over 10 years.*

Recognition of ordinary income on exercise of stock option in S corporation with an ESOP. Under current law, an individual that holds an option in an S corporation is not subject to tax on the income of the S corporation until such individual exercise their option and becomes a shareholder in the S corporation. During the period of time in which an individual holds an option in an S corporation, taxes on the income earned by the S corporation are intended to be paid by the other shareholders in the S corporation. However, a portion of the S corporation's earnings will never be subject to tax if one of the shareholders in the S corporation is a tax-exempt employee stock ownership plan (an "ESOP"). Certain taxpayers have taken advantage of these aspects of current law by having a tax-exempt ESOP hold a significant percentage of an S corporation's stock while taxable individuals hold stock options. The combined effect of this structure is that taxable investors are able to benefit from appreciation in the value of the S corporation while a significant portion of the S corporation's income completely avoids tax. The bill would require these option holders to recognize income when an option is recognized or sold in an amount equal to the amount of income that was shifted to the ESOP through this type of tax planning during the period of time that the option was held by such taxpayer. Interest will be assessed at the underpayment rate on any amounts included under this provision. *This proposal is estimated to raise $606 million over 10 years.*

Termination of special rules for domestic international sales corporation provisions. The bill would terminate the domestic international sales corporation provisions. *This proposal is estimated to raise $881 million over 10 years.*

Clarification of gain recognized in certain spin-off transactions. Under current law, taxes are generally imposed on parent corporations where they extract value in excess of basis from their subsidiaries prior to engaging in a tax free spin-off transaction. Therefore, if a subsidiary corporation distributes cash or other property to its parent in excess of the parent's basis in the subsidiary or if a subsidiary corporation assumes parent debt in excess of the parent's basis in the subsidiary, the parent corporation will recognize gain. However, taxes are not assessed if a subsidiary corporation distributes its own debt securities to a parent corporation prior to a spin off transaction even where the value of these securities would exceed the parent corporation's basis in its subsidiary. The bill would treat distributions of debt securities in a tax free spin-off transaction in the same manner as distributions of cash or other property. *This proposal is estimated to raise $235 million over 10 years.*