

NLWJC - Kagan

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Product Liability

E X E C U T I V E O F F I C E O F T H E P R E S I D E N T

21-May-1996 12:26pm

TO: Bruce R. Lindsey

FROM: Elena Kagan
 Office of the Counsel

SUBJECT: sap continued

I just got hold of the relevant statutory language. On taxation of compensatory damages: Whereas the current provision excludes from gross income damages received "on account of personal injury or sickness," the proposed provision would exclude damages received on account of "personal physical injuries or physical sickness."

DRAFT -- NOT FOR RELEASE

May 21, 1996
(House Rules)

H.R. 3448 - Small Business Job Protection Act
(Archer (R) Texas)

The Administration, while supporting House passage of several provisions in H.R. 3448, will seek amendments to the bill. The Administration strongly opposes the following provisions, which should be deleted from H.R. 3448:

- Section 1501, which would repeal a 1993 Administration initiative that reduces tax incentives for U.S. companies to move jobs and operations abroad. As stated in the President's veto message on the Balanced Budget Act of 1995, which included this provision, the provision would allow businesses to avoid U.S. income taxes by accumulating foreign earnings without limit.
- Section 1601, which would repeal the section 936 tax credit that encourages economic activity in Puerto Rico. The Administration urges the House to replace this provision with its proposal to reform the credit in a manner that rewards such activity and returns the projected revenue savings to Puerto Rico. It is important that legislation concerning the credit contain effective mechanisms to promote job creation in the islands.

The Administration will also work with Congress to adopt other amendments as described below.

Provisions Supported by the Administration
and Additional Recommended Amendments

The Administration supports many provisions of H.R. 3448, which are consistent with Administration proposals to strengthen small businesses, simplify pension laws, and improve incentives for education and work opportunities. The Administration believes that these provisions should be enacted on their own merits, and not as part of a bill to increase the minimum wage.

In particular:

- Small Business Expensing. The Administration strongly supports the bill's increase from \$17,500 to \$25,000 in the amount of tangible personal property that small businesses can expense. The Administration advocated such

an increase in 1993 and in its FY 1997 Budget, although with a faster phase-in.

- Employer-Provided Educational Assistance. The Administration supports the bill's temporary extension of the exclusion for employer-provided educational assistance, and will work with Congress to provide a permanent extension of the exclusion. The Administration, however, opposes the provision that would disallow the exclusion for post-graduate level education.
- Work Opportunity Tax Credit. The provision in H.R. 3448 for a new Work Opportunity Tax Credit addresses a number of the criticisms of the prior Targeted Jobs Tax Credit, particularly increasing the period of retention. The Administration will work with Congress to improve the scope and effectiveness of the new credit. For example, the Administration supports the amendment offered in committee by Rep. Rangel that would have expanded the category of high-risk youth eligible for the credit.
- Pension Simplification. Many provisions of H.R. 3448 were included in the President's pension simplification proposal announced in June 1995 at the White House Conference on Small Business. More can be done, however, to encourage retirement savings by middle and lower-wage workers, such as providing more meaningful employer contributions under the simplified small business plan and a more appropriate definition of highly compensated employees. The Administration is also concerned that the three-year waiver of the excise tax on very large retirement distributions would add complexity and could actually encourage plan sponsors to terminate plans. The Administration hopes to work with Congress in a bipartisan fashion to simplify the law, expand coverage, increase security, and promote portability.
- Subchapter S. The Administration strongly supports the Subchapter S reform package in the bill, and will work with Congress to provide further reforms and ensure that reforms are appropriately targeted to the intended beneficiaries.
- Technical Corrections. The Administration supports the long-overdue enactment of technical corrections to recent tax legislation. However, the Administration opposes several special-interest, late Committee additions to the consensus package of technical corrections. The Administration also opposes the inclusion in H.R. 3448 of various other special-interest provisions.

Revenue Offsets

The Administration has concerns with certain offset provisions in H.R. 3448 and will work with Congress to develop more suitable offsets for the lost tax revenue resulting from the new tax incentives. Two of the offsets -- relating to the so-called income-forecast accounting method and to advance refunds of the diesel fuel tax -- are included in the President's balanced budget proposal and should be reserved for deficit reduction and meeting balanced budget goals. In working with the Congress to develop an improved bill that is consistent with the Administration's recommended amendments, appropriate offsets will be sought.

Administration Proposals Not Addressed in H.R. 3448

The Administration will work with Congress to provide other incentives previously proposed by the Administration but omitted from this bill, such as the tuition and training deduction, expanded Individual Retirement Accounts (including penalty-free withdrawals for education expenses, purchases of first homes, major medical expenses, and unemployment), and revenue-neutral extension of the research tax credit and other expiring provisions.

The Administration will also work with Congress to revitalize economically distressed areas through tax incentives previously proposed by the Administration, including incentives to clean up abandoned, contaminated properties, and to create new Empowerment Zones and Enterprise Communities.

Pay-As-You-Go Scoring

H.R. 3448 would affect receipts; therefore, it is subject to the "pay-as-you-go" requirements of the Omnibus Budget Reconciliation Act of 1990. OMB's scoring of this legislation is under development.

* * * * *

Tax Cuts

pursuant to a special rule, in the case of television and motion picture films, the income from the property shall include income from the financial exploitation of characters, designs, scripts, scores, and other incidental income associated with such films, but only to the extent the income is earned in connection with the ultimate use of such items by, or the ultimate sale of merchandise to, persons who are not related to the taxpayer (within the meaning of sec. 267 (b)). Finally, pursuant to another special rule, if a taxpayer produces a television series and initially does not anticipate syndicating the episodes from the series, the forecasted income for the episodes of the first three years of the series need not take into account any future syndication fees (unless the taxpayer enters into an arrangement to syndicate such episodes during such period). The 10-year rule, the financial exploitation rule, and the syndication rule would apply for purposes of the look-back method described below.

In addition, the cost of property subject to depreciation would only include amounts that satisfy the economic performance standard of section 461 (h). Except as provided in regulations, any costs that are not recovered by the end of the tenth taxable year after the property was placed in service may be taken into account as depreciation in such year.

Finally, taxpayers that claim depreciation deductions under the income forecast method would be required to pay (or would receive) interest based on the recalculation of depreciation under a "look-back" method. The "look-back" method would be applied in any "recomputation year" by: (1) comparing depreciation deductions that had been claimed in prior periods to depreciation deductions that would have been claimed had the taxpayer used actual, rather than estimated, total income from the property; (2) determining the hypothetical overpayment or underpayment of tax based on this recalculated depreciation; and (3) applying the overpayment rate of section 6621 of the Code. Except as provided in regulations, a "recomputation year" would be the third and tenth taxable year after the taxable year the property was placed in service unless the actual income from the property for each period before the close of such years was within 10 percent of the estimated income from the property for such periods. The Secretary of the Treasury would have the authority to allow a taxpayer to delay the initial application of the look-back method where the taxpayer may be expected to have significant income from the property after the third taxable year after the taxable year the property was placed in service (e.g., the Secretary may exercise such authority where the depreciable life of the property is expected to be longer than three years). Property with an adjusted basis of \$100,000 or less when the property was placed in service would not be subject to the look-back method. The bill would provide a simplified look-back method for pass-through entities.

Effective Date

The provision would be effective for property placed in service after September 13, 1995, unless placed in service pursuant to a binding written contract in effect before such date and all times thereafter.

5. Modify exclusion of damages received on account of personal injury or sickness

Present Law

Under present law, gross income does not include any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injury or sickness (sec. 104(a)(2)).

The exclusion from gross income of damages received on account of personal injury or sickness specifically does not apply to punitive damages received in connection with a case not involving physical injury or sickness. Courts presently differ as to whether the exclusion applies to punitive damages received in connection with a case involving a physical injury or physical sickness.⁽¹⁾ Certain States provide that, in the case of claims under a wrongful death statute, only punitive damages may be awarded.

Courts have interpreted the exclusion from gross income of damages received on account of personal injury or sickness broadly in some cases to cover awards for personal injury that do not relate to a physical injury or sickness. For example, some courts have held that the exclusion applies to damages in cases involving certain forms of employment discrimination and injury to reputation where there is no physical injury or sickness. The damages received in these cases generally consist of back pay and other awards intended to compensate the

claimant for lost wages or lost profits. The Supreme Court recently held that damages received based on a claim under the Age Discrimination in Employment Act could not be excluded from income.(12) In light of the Supreme Court decision, the Internal Revenue Service has suspended existing guidance on the tax treatment of damages received on account of other forms of employment discrimination.

Description of Bill

Include in income all punitive damages

The bill would generally provide that the exclusion from gross income does not apply to any punitive damages received on account of personal injury or sickness whether or not related to a physical injury or physical sickness. Under the bill, present law would continue to apply to punitive damages received in a wrongful death action if the applicable State law (as in effect on September 13, 1995 without regard to subsequent modification) provides, or has been construed to provide by a court decision issued on or before such date, that only punitive damages may be awarded in a wrongful death action. The bill would intend no inference as to the application of the exclusion to punitive damages prior to the effective date of the bill in connection with a case involving a physical injury or physical sickness.

Include in income damage recoveries for nonphysical injuries

The bill would provide that the exclusion from gross income only applies to damages received on account of a personal physical injury or physical sickness. If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom would be treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party. For example, damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of such individual's spouse would be excludable from gross income. In addition, damages (other than punitive damages) received on account of a claim of wrongful death would continue to be excludable from taxable income as under present law.

The bill also would specifically provide that emotional distress is not considered a physical injury or physical sickness.(13) Thus, the exclusion from gross income would not apply to any damages received (other than for medical expenses as discussed below) based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. Because all damages received on account of physical injury or physical sickness are excludable from gross income, the exclusion from gross income would apply to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness. In addition, the exclusion from gross income specifically would apply to the amount of damages received that is not in excess of the amount paid for medical care attributable to emotional distress.

The bill would intend no inference as to the application of the exclusion to damages prior to the effective date of the bill in connection with a case not involving a physical injury or physical sickness.

Effective Date

The provisions generally would be effective with respect to amounts received after June 30, 1996. The provisions would not apply to amounts received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995

~~6. Repeal advance refunds of diesel fuel tax for purchasers of diesel-powered automobiles, vans, and light trucks~~

~~Present Law~~

~~Excise taxes are imposed on gasoline (14 cents per gallon) and diesel fuel (20 cents per gallon) to fund the Federal Highway Trust Fund. Before 1985, the gasoline and diesel fuel tax rates were the same. The predominate highway use of diesel fuel is by trucks. In 1984, the diesel excise tax rate was increased above the gasoline tax rate~~

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
Washington, D.C. 20503-0001

LRM NO: 4479

FILE NO: 2326

5/17/96

LEGISLATIVE REFERRAL MEMORANDUM

Total Page(s): _____

TO: Legislative Liaison Officer - See Distribution below:

FROM: James JUKES *[Signature]* (for) Assistant Director for Legislative Reference

OMB CONTACT: Ronald JONES 395-3386 Legislative Assistant's Line: 395-3454
C=US, A=TELEMAIL, P=GOV+EOP, O=OMB, OU1=LRD, S=JONES, G=RONALD, I=E
jones_re@a1.eop.gov

SUBJECT: Proposed Statement of Administration Policy RE: HR3448, Small Business Job Protection Act of 1996

DEADLINE: 4:00 PM Friday, May 17, 1996

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President.

Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.

COMMENTS: A HARD COPY OF THIS LRM IS ALSO BEING FAXED/DELIVERED TO YOU.

*Maybe attached to minnow in Henry this alt
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see way take this bill. could*

Current SAP

*objective
objects not mentioned.
May be domino effect.*

LEGISLATIVE REFERRAL MEMORANDUM
Distribution List**LRM NO: 4479****FILE NO: 2326****SUBJECT: Proposed Statement of Administration Policy RE: HR3448, Small Business Job Protection Act of 1996****AGENCIES:**

7-AGRICULTURE - Marvin Shapiro - 2027201516
25-COMMERCE - Michael A. Levitt - 2024823151
18-Council of Economic Advisers - Liaison Officer (vacant) - 3955084
30-EDUCATION - Jack Kristy - 2024018313
54-HUD - Vacant - 2027081793
59-INTERIOR - Jane Lyder - 2022086708
62-LABOR - Robert A. Shapiro - 2022198201
76-National Economic Council - Sonyia Matthews - 2024562174
87-Pension Benefit Guaranty Corporation - Gail Sevin - 2023264080
108-Securities and Exchange Commission - Kaye F. Williams - 2029420014
107-Small Business Administration - Mary Kristine Swedin - 2022058700
110-Social Security Administration - Judy Chesser - 2024827148
117-TRANSPORTATION - Tom Herlihy - 2023664687
118-TREASURY - Richard S. Carro - 2026221146

EOP:

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Kountoupes_L
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BRIATICO_a
TORNQUIST_D
BEARD_B
REA_E
LIND_S

DRAFT -- NOT FOR RELEASE

May 17, 1996
(House Rules)

H.R. 3448 - Small Business Job Protection Act
(Archer (R) Texas and xx cosponsors)

The Administration supports House passage of H.R. 3448, but will seek amendments to delete two provisions that it strongly opposes:

- Section 1603(i), which would repeal a 1993 Administration initiative that reduces tax incentives for U.S. companies to move jobs and operations abroad. As stated in the President's veto message on the Balanced Budget Act of 1995, which included this provision, the provision would allow businesses to avoid taxes by accumulating foreign earnings without limit.
- Section 1501, which would repeal the section 936 tax credit that encourages economic activity in Puerto Rico. The Administration urges the House to replace this provision with its proposal to reform section 936 in a manner that rewards such activity and returns the projected revenue savings to Puerto Rico. It is important that legislation concerning section 936 contain effective mechanisms to promote job creation in the islands.

The Administration will seek other amendments to H.R. 3448, as described below.

Provisions Supported by the Administration and Additional Recommended Amendments

The Administration supports many provisions of H.R. 3448, which are consistent with Administration proposals to strengthen small businesses, simplify pension laws, and improve incentives for education and work opportunities. The Administration believes that these provisions should be enacted on their own merits, and not as part of a bill to increase the minimum wage.

In particular:

- Small Business Expensing. The Administration strongly supports the bill's increase from \$17,500 to \$25,000 in the amount of tangible personal property that small businesses can expense. The Administration advocated such

an increase in 1993 and in its FY 1997 Budget, although with a faster phase-in.

- Employer-Provided Educational Assistance. The Administration supports the bill's temporary extension of the exclusion for employer-provided educational assistance, and will work with Congress to provide a permanent extension of the exclusion. The Administration, however, opposes the provision that would disallow the exclusion for post-graduate level education.
- Work Opportunity Tax Credit. The provision in H.R. 3448 for a new Work Opportunity Tax Credit addresses many of the criticisms of the prior Targeted Jobs Tax Credit. The Administration will work with Congress to improve the scope and effectiveness of the new credit. For example, the Administration supports the amendment offered in committee by Rep. Rangel which would have expanded the category of high-risk youth eligible for the credit.
- Pension Simplification. Many provisions of H.R. 3448 were included in the President's pension simplification proposal announced last June at the White House Conference on Small Business. More can be done, however, to encourage retirement savings by middle and lower-wage workers. The Administration hopes to work with Congress in a bipartisan fashion to simplify the law, expand coverage, and promote portability. The Administration is concerned that the three-year waiver on the excise tax imposed on very large retirement distributions could actually add complexity and encourage plan sponsors to terminate plans.
- Subchapter S. The Administration strongly supports the Subchapter S reform package in the bill, and will work with Congress to provide further reforms and ensure that reforms are appropriately targeted to the intended beneficiaries.
- Technical Corrections. The Administration supports the long-overdue enactment of technical corrections to recent tax legislation. However, the Administration opposes several special-interest, late additions to the consensus package of technical corrections. These provisions were not added pursuant to the traditional bicameral, bipartisan process for technical corrections. The Administration also opposes the inclusion in H.R. 3448 of various other special-interest provisions[, such as _____].

Revenue Offsets

The Administration has concerns with certain offset provisions in H.R. 3448 and will work with Congress to develop more suitable offsets to the lost tax revenue resulting from the new tax incentives. Two of the offsets -- relating to the so-called income-forecast accounting method and to advance refunds of the diesel fuel tax -- are included in the President's balanced budget proposal and should be reserved for deficit reduction. In working with the Congress to develop an improved bill that is consistent with the Administration's recommended amendments, appropriate offsets will be sought.

Administration Proposals Not Addressed in H.R. 3448

The Administration will work with Congress to provide other incentives previously proposed by the Administration but omitted from this bill, such as the tuition and training deduction, tax incentives for distressed areas, expanded Individual Retirement Accounts (including penalty-free withdrawals for education expenses and unemployment), and revenue-neutral extension of the research tax credit and other expiring provisions.

The Administration will also work with Congress to revitalize economically distressed areas through tax incentives previously proposed by the Administration, including incentives to clean up abandoned, contaminated properties, and to create new Empowerment Zones and Enterprise Communities.

Pay-As-You-Go Scoring

[Insert Treasury scoring or a statement that scoring is under development.]

* * * * *

~~at all times thereafter before such production or acquisition.~~

SEC. 1505. REPEAL OF EXCLUSION FOR PUNITIVE DAMAGES AND FOR DAMAGES NOT ATTRIBUTABLE TO PHYSICAL INJURIES OR SICKNESS.

(a) IN GENERAL.--Paragraph (2) of section 104(a) (relating to compensation for injuries or sickness) is amended to read as follows:

"(2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness."

(b) EMOTIONAL DISTRESS AS SUCH TREATED AS NOT PHYSICAL INJURY OR PHYSICAL SICKNESS.--Section 104(a) is amended by striking the last sentence and inserting the following new sentence: "For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness. The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress."

(c) SPECIAL RULE FOR STATES IN WHICH ONLY PUNITIVE DAMAGES MAY BE AWARDED IN WRONGFUL DEATH ACTIONS.--Section 104 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) RESTRICTION ON PUNITIVE DAMAGES NOT TO APPLY IN CERTAIN CASES.--The restriction on the application of subsection (a)(2) to punitive damages shall not apply to punitive damages awarded in a civil action--

"(1) which is a wrongful death action, and

"(2) with respect to which applicable State law (as in effect on September 13, 1995 and without regard to any modification after such date) provides, or has been construed to provide by a court of competent jurisdiction pursuant to a decision issued on or before September 13, 1995, that only punitive damages may be awarded in such an action.

This subsection shall cease to apply to any civil action filed on or after the first date on which the applicable State law ceases to provide (or is no longer construed to provide the treatment described in paragraph (2))."

(d) EFFECTIVE DATE.--

(1) IN GENERAL.--Except as provided in paragraph (2), the amendments made by this section shall apply to amounts received after December 31, 1995, in taxable years ending after such date.

(2) EXCEPTION.--The amendments made by this section shall not apply to any amount received under a written binding agreement court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

~~SEC. 1506. REPEAL OF DIESEL FUEL TAX REBATE TO PURCHASERS OF DIESEL-POWERED AUTOMOBILES AND LIGHT TRUCKS.~~

~~(a) IN GENERAL.--Section 6427 (relating to fuels not used for taxable purposes) is amended by striking subsection (g).~~

~~(b) CONFORMING AMENDMENTS.--~~

~~(1) Paragraph (3) of section 34(a) is amended to read as follows:~~

E X E C U T I V E O F F I C E O F T H E P R E S I D E N T

21-May-1996 10:23am

TO: Bruce R. Lindsey

FROM: Elena Kagan
 Office of the Counsel

SUBJECT: SAP

OMB just called me about the Administration's proposed SAP on the Small Business Job Protection Act. The SAP supports passage of this bill, which (in OMB's words) contains provisions "to strengthen small businesses, simplify pension laws, and improve incentives for education and work opportunities." The SAP indicates, however, that the Administration will seek amendments to delete two provisions -- a repeal of a tax credit that encourages economic activity in Puerto Rico and a repeal of an Administration initiative that reduces tax incentives for US companies to move operations abroad.

One question OMB raises is whether we also want to object to a provision of the bill that imposes income tax on most punitive damage awards. (There is an exception for punitives in wrongful death actions in any state that limits damages in such actions to punitives.) Treasury likes the provision. At least on first blush, I do too. Given that punitive damage awards are essentially a windfall to the plaintiff, necessary to ensure the public good, there is no reason to exclude the normal portion of such monies from going to the public.

A second question relates to a provision that would subject to income tax compensatory damages that are not "received on account of a personal physical injury or physical sickness." I take it that the current exclusion from income tax has been interpreted by some courts to apply in, for example, certain employment discrimination or defamation cases, even though the current exclusion also refers to personal injury or sickness. This provision is supposed to prevent such a broad interpretation. The committee report on the provision notes that damages for emotional distress are excludable from gross income if the distress arises from physical injury or, if it does not, to the extent the distress has led to medical expenses. I think this change is problematic: it clearly assumes that some kind of compensatory damages are more "real" than others (though the current statutory language seems to do so as well). What do you think; is this worth objecting to?