[JOINT COMMITTEE PRINT]

DESCRIPTION OF PROPOSALS RELATING TO MIDDLE INCOME TAX RELIEF AND ECONOMIC GROWTH

SCHEDULED FOR HEARINGS

BEFORE THE

HOUSE COMMITTEE ON WAYS AND MEANS

ON DECEMBER 17-18, 1991

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of proposals relating to middle income tax relief and economic growth, scheduled for public hearings before the House Committee on Ways and Means on December 17-18, 1991.

Part I of the pamphlet is a summary of the proposals. Part II is a description of the proposals, including present law, explanation of the provisions, and effective dates.

The proposals have been categorized as follows: (A) middle income tax relief and economic growth proposals (proposals with several tax relief or incentive provisions); (B) personal exemption, standard deduction, and child and earned income tax credit proposals; (C) capital gains, passive losses, and other investment incentive proposals; (D) individual retirement arrangement and homebuyers' tax credit proposals; and (E) other proposals.

This pamphlet does not include any revenue estimates of the proposals. Chairman Rostenkowski has directed that revenue estimates be prepared for the proposals described in this pamphlet. However, because the Congressional Budget Office (CBO) will, within the next few weeks, announce revised macroeconomic baseline assumptions, the staff of the Joint Committee on Taxation will wait to prepare such estimates until the revised CBO baseline assumptions have been announced.

This pamphlet does not include revenue provisions in the President's fiscal year 1992 budget proposal, which was submitted to the Congress on February 4, 1991.[2]

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of Proposals Relating to Middle Income Tax Relief and Economic Growth* (JCS-17-91), December 10, 1991.

[2] For a summary description of the President's revenue proposals, see Joint Committee on Taxation, *Summary of Revenue Provisions in the President's Fiscal Year 1992 Budget Proposal* (JCS-1-91), February 25, 1991.

I. SUMMARY OF PROPOSALS

A. Middle Income Tax Relief and Economic Growth Proposals

1. H.R. 3730—"The Middle Income Tax Relief and Fairness Act of 1992" (Messrs. Rostenkowski, Gephardt, Pease, Downey, Rangel, Matsui, Anthony, Dorgan of North Dakota, Donnelly, Coyne, Levin of Michigan, Cardin, McDermott, and others)

The bill would provide a refundable income tax credit based on an employee's social security tax liability. The bill also would create a 35-percent individual income tax bracket, increase the individual minimum tax, and impose a surtax on individuals with taxable income over $1,000,000.

The bill would be effective for taxable years beginning after December 31, 1991.

2. "The Economic Growth, Investment and Job Creation Act" (House Republican Conference)

Overview

The proposal would (1) allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets, (2) provide taxpayers with a capital gain deduction with respect to dispositions of qualified small business stock, (3) provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets for purposes of determining gain or loss upon sale or other disposition, (4) provide that losses from the sale or exchange of a principal residence would be treated as a capital loss, (5) increase the amount that a taxpayer can expense for any taxable year in lieu of recovering such amount through depreciation deductions, (6) increase the amount of income an individual can earn before the social security earnings limit applies, (7) provide that the passive loss limitation would not apply to losses and credits from certain rental real estate activities of taxpayers engaged in the real property business, (8) specifically exempt qualified apprenticeship education organizations from taxation and allow a 20-percent income tax credit for contributions to these organizations, (9) permit individuals to establish and make nondeductible contributions to IRA plus accounts, (10) permit certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home, (11) permit taxpayers with adjusted gross incomes up to $50,000 to exclude from gross income the first $225 of interest received ($450 in the case of a joint return), and (12) repeal the excise taxes on luxury items.

The specific provisions of the proposal are summarized below.

Deduction for capital gains

The proposal would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held three years or more would qualify for a 30-percent exclusion; assets held at least two years but less than three years would qualify for a 20-percent exclusion; and assets held at least one year but less than two years would qualify for a 10-percent exclusion.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded. The capital gains exclusion would be a preference for purposes of the alternative minimum tax.

The capital gain provisions of the proposal would apply to dispositions made on or after September 30, 1991. For the portion of 1991 to which the proposal would apply, a 30-percent exclusion would apply for all assets held one year or more. For 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years.

50-percent capital gains exclusion on venture capital investments; seed capital gain deduction

The proposal would provide taxpayers with a capital gain deduction with respect to dispositions of qualified small business stock. Taxpayers who have held qualified small business stock for more than five years would be allowed a deduction equal to 50 percent of their qualified small business net capital gain.

Qualified small business stock would be stock issued after December 31, 1991, acquired at original issue for money or as compensation for services. At the time of issue, the amount of money, the adjusted basis of property and the value of services received by the corporation for stock as a contribution to capital and as paid-in surplus, plus the accumulated earnings and profits of the corporation, could not exceed $100 million. In addition, the corporation must conduct an active business and use substantially all its assets in an active business during the 5-year period commencing with the acquisition of the stock.

The qualified small business capital gain deduction would be treated as a preference item under the alternative minimum tax.

The proposal would provide taxpayers with a seed capital gain deduction with respect to dispositions of qualified small business stock in corporations with paid-in capital and surplus not in excess of $5 million. The deduction for seed capital gain would be on a sliding scale, depending on holding period: 50 percent for five to six years, 60 percent for six to seven years, 70 percent for seven to eight years, 80 percent for eight to nine years, 90 percent for nine to 10 years, and 100 percent for more than 10 years.

The seed capital gain deduction would not be treated as a preference item under the alternative minimum tax.

The amount of money and other property that a small business corporation under section 1244 can receive for stock as a contribution to capital and as paid-in surplus would be increased from $1 million to $5 million.

These provisions of the proposal would apply to stock issued after December 31, 1991. If a taxpayer holds appreciated stock that would have been treated as qualified small business stock at the time it was issued had these rules been in place, the taxpayer may elect to recognize all accrued gain with respect to such stock. In such event, any subsequent gains would be eligible for the qualified small business capital gain deduction or the seed capital gain deduction. The holding period for such stock would begin on the date the gain is recognized.

Indexing basis of certain assets

The proposal would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion, and amortization would be determined without regard to the inflation adjustment.

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1993). In the case of stock in regulated investment companies and real estate investment trusts and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The indexing provisions of the proposal would apply to dispositions after December 31, 1993.

Loss on the sale of principal residence

The proposal would provide that losses from the sale or exchange of a principal residence would be treated as a capital loss, effective for sales and exchanges after December 31, 1991.

Expensing of certain depreciable property

The proposal generally would allow a taxpayer to expense and deduct up to $18,200 of the cost of certain tangible personal property that is placed in service in a taxable year for use as an integral part of manufacturing, production, or extraction.

The proposal would be effective for taxable years beginning after December 31, 1991.

Increase social security earnings limitation

The proposal would increase by $1,000 per year over a period of 5 years the income threshold at which Social security benefits are reduced. The proposal would apply to taxable years ending after 1991.

Passive loss rules

The proposal would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of taxpayers engaged in the real property business. The proposal would be effective with respect to taxable years beginning after December 31, 1991.

Leading employers into apprentice programs ("LEAP")

The proposal would specifically exempt apprenticeship education organizations from taxation. Apprenticeship education organizations would be organizations that were organized and operated solely for purposes of administering a qualified apprenticeship education program and that satisfied certain additional organizational tests.

The proposal also would permit a 20-percent income tax credit for contributions made by businesses to any apprenticeship education organization. The deduction to employers for contributions to such organizations would not be reduced by the amount of the credit.

The proposal would apply to years beginning after December 31, 1991.

Individual retirement arrangements (IRAs)

IRA plus accounts

The proposal would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59½ or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from normal IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. A special transition rule would apply to rollovers made before June 30, 1993.

Penalty-free IRA withdrawals for qualified expenses

The proposal would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home. Individuals also could withdraw funds to help children and grandchildren purchase a first home.

Effective date

The proposal would apply to taxable years beginning after December 31, 1991.

Interest exclusion for middle-income taxpayers

The proposal would exclude from gross income the first $225 of interest received ($450 in the case of a joint return). The amount of the exclusion available would be phased out for taxpayers with adjusted gross income (AGI) in the range of $50,000-$60,000 ($25,000-$35,000 for married, filing separately). For purposes of this proposed exclusion, some fraction of the dividends from real estate investment companies (RICs) and real estate investment trusts (REITs) may be treated as interest. The proposal would apply with respect to taxable years beginning after December 31, 1991.

Repeal the luxury excise taxes

The proposal would repeal the 10-percent excise tax on luxury items, effective on the date of enactment.

3. H.R. 960—"Economic Growth and Jobs Creation Act of 1991" (Messrs. DeLay, Tallon, Darden, Armey, Ballenger, Boehner, Cox, Dannemeyer, Doolittle, Hancock, Herger, Riggs, Weber, and others)

Social security tax rates

The bill would lower the social security tax rate for employers and employees from 6.2 percent to 5.3 percent, and the corresponding tax rate for self-employed individuals from 12.4 percent to 10.6 percent.

Capital gains and indexing

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent. For purposes of computing a taxpayer's personal exemption and itemized deduction phaseouts, the taxpayer's AGI would be reduced by any net capital gain. The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill.

The bill would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion, and amortization would be determined without regard to the inflation adjustment. Special proration rules would apply to stock in regulated investment companies and real estate investment trusts and interests in common trust funds, based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The capital gain provisions of the bill would apply to sales or exchanges occurring after June 30, 1991. The provision that would provide for the indexing of the limitation on capital losses would apply to tax years beginning after December 31, 1991.

Depreciation

The bill would index the ACRS depreciation allowances for certain tangible property placed in service in taxable years beginning after 1990. In addition, for taxable years beginning after 1996, the bill would adjust (and would phase in the adjustments to) the ACRS depreciation allowances for tangible property to eventually allow the expensing of the cost of such property in the year the property is placed in service.

Individual retirement arrangements (IRAs)

The bill would permit individuals to make nondeductible contributions to IRA plus accounts. Amounts held in IRA plus accounts could be withdrawn tax-free if the withdrawal is a qualified distribution and the withdrawal occurs at least 5 years after the individual first made a contribution to the IRA plus account. Contributions to an IRA plus account generally could not exceed $2,000 per year.

Social security benefit taxation

Beginning after 1996, the bill would adjust for inflation the income thresholds for determining whether a portion of social security benefits is taxable, and would exclude from income for this purpose withdrawal from IRAs.

4. H.R. 2242—"Working Family Tax Relief Act of 1991" (Messrs. Downey, Miller of California, Obey, Stark, DeLugo, Donnelly, Rangel, Gibbons, Jacobs, Matsui, and others)

The bill would replace the present-law personal exemption for children under 18 with an $800 refundable income tax credit. The bill would repeal the young child, supplemental health insurance, and family-size adjustment components of the earned income tax credit (EITC), and would increase the basic EITC credit rate. The bill would repeal present-law provisions that reduce personal exemptions and itemized deductions for higher-income individuals. The bill would increase individual income tax rates and impose a surtax on high-income individuals.

The bill generally would be effective for taxable years beginning after December 31, 1991, except that the tax credit for dependent children and the surtax would be effective for taxable years beginning after December 31, 1992.

5. H.R. 3128—"All Americans Savings and Investment Incentive Act of 1991" (Messrs. Gallo, Michel, Lewis of California, Edwards of Oklahoma, Vander Jagt, Solomon, Walker, Cox of California, Hastert, Armay, and others)

Capital gains exclusion

The bill would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held 3 years or more would qualify for a 30-percent exclusion; assets held at least 2 years but less than 3 years would qualify for a 20-percent exclusion; and assets held at least one year but less than 2 years would qualify for a 10-percent exclusion. The provision would be effective for sales and exchanges after September 30, 1991.

Interest exclusion

The bill also would exclude from gross income the first $350 of interest received ($700 in the case of a joint return). The amount of the exclusion available would be phased out for taxpayers with adjusted gross income (AGI) in the range of $50,000-$60,000 ($25,000-$35,000 for married, filing separately). The provision would apply with respect to taxable years beginning after December 31, 1991.

6. H.R. 3130—"Economic Growth Act of 1991" (Messrs. Gingrich, Gunderson, Walker, McCollum, Ireland, Mrs. Johnson of Conn., Messrs. Kyl, Hastert, McEwen, Kasich, Ramstad, Thomas of Wyoming, Rohrabacher, and Hunter)

Overview

The bill would (1) allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets, (2) provide individuals with an inflation adjustment to (i.e., indexing of) the basis of certain assets for purposes of determining gain upon sale or other disposition, (3) authorize the Secretary of the Department of Housing and Urban Development (HUD) to designate up to 50 enterprise zones, companies in which (and stockholders of such companies) would receive favorable tax treatment, (4) permanently extend the tax credit for qualified research expenditures (including university basic research payments), (5) permit individuals to establish and make nondeductible contributions to IRA plus accounts, (6) give first-time home buyers with adjusted gross income less than $41,000 a refundable tax credit of up to $1,000 for the purchase of a principal residence, (7) permit certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home, or for certain medical or education expenses, (8) increase the amount of income an individual can earn before the social security earnings limit applies, and (9) increase the amount of the personal exemption for taxable years following the declaration of an economic growth dividend by the Secretary of the Treasury.

The following is a summary of the specific provisions of the bill.

Capital gains and indexing; depreciation recapture

The bill would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held three years or more would qualify for a 30-percent exclusion; assets held at least two years but less than three years would qualify for a 20-percent exclusion; and assets held at least one year but less than two years would qualify for a 10-percent exclusion.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded. The capital gains exclusion would be a preference for purposes of the alternative minimum tax.

Under the bill, gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

The bill generally would provide individuals with an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations, and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

The inflation adjustment under the bill would be computed by dividing the consumer price index ("CPI") in the calendar year preceding the year the disposition occurs by the CPI in the calendar year preceding the year in which the asset was acquired by the taxpayer. In the case of stock in regulated investment companies ("RICs") and real estate investment trusts ("REITs"), partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The capital gain provisions of the bill would apply to dispositions made on or after April 15, 1991. For the portion of 1991 to which the proposal would apply, a 30-percent exclusion would apply for all assets held one year or more. For 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years. The indexing provisions of the bill generally would apply to dispositions of any property the holding period of which begins after April 15, 1991.

Enterprise zones

Tax provisions

The bill would authorize the Secretary of HUD to designate up to 50 enterprise zones over a four-year period. The designations generally would remain in effect for 25 years. With respect to the designated zones, the following tax incentives would apply:

Employment tax credit—A 5-percent refundable tax credit would be provided to certain enterprise zone employees for their first $10,500 of wages.

Capital gain exclusion—Long-term capital gain realized from the disposition of certain property (excluding financial property and collectibles) used in an enterprise zone business for at least two years would be excluded from income.

Deduction for enterprise zone stock—Individuals could elect to deduct up to $50,000 per year of the purchase price of certain enterprise zone stock, subject to a $250,000 lifetime limitation. The deduction would be treated as a preference item for alternative minimum tax purposes. A corporation could not issue more than $5 million of stock eligible for the deduction.

Non-tax provisions

The bill also contains the following non-tax provisions with respect to enterprise zones: (1) applications for establishment of a foreign trade zone within an enterprise zone would be processed on a priority basis; (2) the definition of a small entity would be expanded for purposes of the Regulatory Flexibility Act; and (3) Title VII of the Housing and Community Development Act of 1987 would be repealed.

Effective date

The enterprise zone tax provisions would be effective for taxable years ending after December 31, 1990. The non-tax provisions generally would be effective upon enactment.

Permanent extension of research credit

The bill would permanently extend the 20-percent tax credit for qualified research expenditures, effective for taxable years beginning after December 31, 1990.

Individual retirement arrangements (IRAs)

IRA plus accounts

The bill would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59-1/2 or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from normal IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. A special transition rule applies to rollovers made before June 30, 1993.

Penalty-free IRA withdrawals for qualified expenses

The bill would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home, certain education expenses, and certain medical expenses. Individuals also could withdraw funds to help children and grandchildren with a qualified expense.

Effective date

The provision would apply to taxable years beginning after December 31, 1991.

Increase social security earnings limitation

The bill would increase by $1,000 per year over a period of 5 years the income threshold at which social security benefits are reduced. The provision would apply to taxable years ending after 1991.

First-time homebuyers' tax credit

The bill would give qualified first-time homebuyers a refundable tax credit of $1,000 for the purchase of a principal residence, effective for purchases after July 31, 1991.

Growth dividend—increase in personal exemption

The bill would increase the amount of the personal exemption in taxable years following the declaration of an "economic growth dividend" by the Secretary of the Treasury.

7. "Family and Corporate Tax Sense Act of 1992" (Mr. Schulze), including H.R. 3170—"The Uniform Business Tax Act of 1991"

The following provisions were proposed by Mr. Schulze in a press release dated December 3, 1991.

H.R. 3170—"The Uniform Business Tax Act of 1991" (Messrs. Schulze, Guarini, Thomas, Applegate, Bustamante, Cunningham, DeFazio, Duncan, Fish, Gekas, Horton, Huckaby, Hunter, Lent, Lipinski, Moran, Ravenel, Regula, Rowland, Skeen and Mr. Walsh, and Mrs. Bentley and Ms. Kaptur)

Under H.R. 3170, for taxable years beginning after 1990, a tax (the "uniform business tax" ("UBT")) would be imposed equal to 9 percent of the taxable value of goods and services produced and sold in the United States by a taxable business. The UBT would replace the corporate income tax and the corporate alternative minimum tax, which would be repealed under the bill. In addition, the UBT is creditable against the payroll tax liability of an employer. To the extent a corporation's payroll tax liability exceeds its UBT liability, such excess may be carried forward and credited against future UBT liability. For a noncorporate taxpayer, the portion of the UBT in excess of the payroll tax liability may be credited against the taxpayer's income tax. The UBT also would be imposed on the customs value of imported property, with a de minimis exception for certain personal use items.

H.R. 3170 would be effective for taxable years beginning after December 31, 1990.

Capital gains exclusion; depreciation recapture

The proposal would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held 3 years or more would qualify for a 30-percent exclusion; assets held at least 2 years but less than 3 years would qualify for a 20-percent exclusion; and assets held at least one year but less than 2 years would qualify for a 10-percent exclusion.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded. The capital gains exclusion would be a preference for purposes of the alternative minimum tax.

Under the bill, gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

The bill would apply to dispositions (and installment payments received) after date of enactment. For the portion of 1991 to which the proposal would apply, a 30-percent exclusion would apply for all assets held one year or more. For 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years.

Social security payroll taxes

The proposal would reduce the social security payroll tax rates by 1 percentage point, beginning in 1993.

H.R. 1287—Exclusion of gain on the sale of a principal residence (Messrs. Schulze, Thomas of Calif., Bunning, and others)

The bill would repeal the age and dollar limitations on the one-time exclusion of gain from the sale of a principal residence under present law, effective for sales after the date of enactment.

Increase in personal exemption

The proposal would increase the personal exemption for dependent children under age 18 to $3,500 in 1993.

8. H.R. 3678—"Economic Growth Act of 1991" (Mr. Walker)

Capital gains and indexing; depreciation recapture

Under the bill, an individual would be allowed a deduction equal to 33 percent of net capital gain for the taxable year. Net gain from the sale of collectibles would not be eligible for the deduction. The capital gain deduction would not apply for purposes of computing alternative minimum taxable income.

Under the bill, gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

The bill generally would provide individuals with an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations, and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment. In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs), partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The capital gain provisions of the bill would apply to taxable years beginning after the date of enactment. The depreciation recapture provisions would apply to dispositions made after the date of enactment. The indexing provisions generally would apply to dispositions of any property the holding period of which begins after the date of enactment.

Enterprise zones

Tax provisions

The bill would authorize the Secretary of HUD to designate up to 50 enterprise zones over a four-year period. Zone designations generally would remain in effect for 25 years. With respect to the designated zones, the following tax incentives would apply:

Employment tax credit—A 5-percent refundable tax credit would be provided to certain enterprise zone employees for their first $10,500 of wages.

Capital gain exclusion—Long-term capital gain realized from the disposition of certain property (excluding financial property and collectibles) used in an enterprise zone business for at least two years would be excluded from income.

Deduction for enterprise zone stock—Individuals could elect to deduct up to $50,000 per year of the purchase price of certain enterprise zone stock, subject to a $250,000 lifetime limitation. The deduction would be treated as a preference item for alternative minimum tax purposes. A corporation could not issue more than $5 million of stock eligible for the deduction.

Non-tax provisions

The bill also contains the following non-tax provisions with respect to enterprise zones: (1) applications for establishment of a foreign trade zone within an enterprise zone would be processed on a priority basis; (2) the definition of a small entity would be expanded for purposes of the Regulatory Flexibility Act; and (3) Title VII of the Housing and Community Development Act of 1987 would be repealed.

Effective date

The enterprise zone tax provisions would be effective for taxable years ending after the date of enactment. The non-tax provisions generally would be effective upon enactment.

Permanent extension of research credit

The bill would permanently extend the 20-percent tax credit for qualified research expenditures, effective for taxable years beginning after December 31, 1990.

Individual retirement arrangements (IRAs)

IRA plus accounts

The bill would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59-1/2 or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from normal IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. A special transition rule applies to rollovers made before June 30, 1993.

Penalty-free IRA withdrawals for qualified expenses

The bill would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home, certain education expenses, and certain medical expenses. Individuals also could withdraw funds to help children and grandchildren with a qualified expense.

Effective date

The provision would apply to taxable years beginning after December 31, 1991.

Credit for the purchase of a principal residence by a first-time homebuyer

The bill would provide qualified first-time homebuyers a refundable income tax credit of $1,000, effective for purchases after the date of enactment.

Increase in social security earnings limitation

The bill would increase by $1,000 per year over a period of 6 years the income threshold at which social security benefits are reduced. The provision would apply to taxable years ending after 1991.

Individual income tax rates; minimum tax rate

The bill would reduce individual income tax rates by one-fourth and would reduce the individual alternative minimum tax from 24 percent to 16 percent, effective for taxable years beginning after the date of enactment.

Budget sequestration

The bill would call for a sequestration, other than for exempt accounts (benefits under Title II of the Social Security Act or under section 3(a), 3(f)(3), 4(a) or 4(f) of the Railroad Retirement Act of 1974, and interest on U.S. debt), to offset any reduction in Federal revenues from the tax provisions of the bill.

9. H.R. 3680—"The Family Tax Relief Act of 1991" (Messrs. Russo, Guarini, Ms. Pelosi, and Mr. Miller of California)

The bill would provide a refundable tax credit equal to $350 for each dependent child under age 18, and would reduce certain spending and modify the budget process to offset the cost of this credit.

The bill would be effective for taxable years beginning after December 31, 1991.

10. H.R. 3744—"Economic Growth and Family Tax Freedom Act of 1991" (Messrs. Weber, DeLay, Wolf, Armey, Ramsted, Smith of Texas, Doolittle, Packard, McEwen, Santorum, Zimmer, Cox of California, Walker, Rohrabacher, Boehner, Kye, Ireland, Broomfield, Dickinson, Cunningham, Barrett, Skeen, Riggs, Tallon, Paxon, Ravenel, Sensenbrenner, Thomas of Wyoming, Walsh, Solomon, and Camp)

Overview

The bill would (1) allow taxpayers to claim a nonrefundable tax credit of $1,000 for children younger than age 6 and $300 for children younger than age 19, (2) reduce the maximum capital gains tax rate to 15 percent (7.5 percent in the case of individuals in the 15-percent bracket) and provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets for purposes of determining gain or loss, (3) exclude from gross income any gain from the sale of a principal residence, (4) modify the depreciation allowance rules, (5) permit individuals to establish and make nondeductible contributions to IRA plus accounts, (6) provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of taxpayers engaged in the real property business, and (7) authorize the Secretary of the Department of Housing and Urban Development (HUD) to designate up to 50 enterprise zones, companies in which (and stockholders of such companies) would receive favorable tax treatment.

Tax credit for children

The bill would allow taxpayers to claim a nonrefundable tax credit equal to (1) $1,000 for each qualifying child of the taxpayer who had not reached the age of 6, and (2) $300 for each qualifying child of the taxpayer who had attained the age of 6 but who had not reached the age of 19. The provision would apply to taxable years beginning after December 31, 1990.

Capital gains and indexing

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent. For purposes of computing a taxpayer's personal exemption and itemized deduction phaseouts, the taxpayer's AGI would be reduced by any net capital gain. The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill.

The bill would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion, and amortization would be determined without regard to the inflation adjustment.

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1991). In the case of stock in regulated investment companies and real estate investment trusts and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The provisions generally would apply to sales or exchanges occurring after December 31, 1991. The provision that would provide for the indexing of the limitation on capital losses would apply to tax years beginning after December 31, 1991.

Exclusion of gain on the sale of a principal residence

The bill would exclude from gross income any gain from the sale of a principal residence (i.e., the bill would repeal the dollar, age, use, and one-time limitations on the exclusion of gain on the sale of a principal residence).

The bill would apply to sales occurring after December 31, 1991, in taxable years ending after that date.

Depreciation and expensing

The bill would index the ACRS depreciation allowances for certain tangible property placed in service in taxable years beginning after 1991, replace the 200-percent declining balance method of current law with the 125-percent declining balance method, and phaseout the alternative minimum tax adjustments related to depreciation. In addition, for taxable years beginning after 1996, the bill would adjust (and phases-in the adjustments to) the ACRS depreciation allowances for tangible property to eventually allow taxpayers to expense the cost of such property in the year the property is placed in service. Thus, after the periods provided for all the phase-ins and phase-outs under the bill, taxpayers would be allowed to expense (rather than depreciate) the cost of tangible property placed in service for regular tax and alternative minimum tax purposes.

The depreciation indexing provision would be effective for qualifying property placed in service in taxable years beginning after December 31, 1990, and the expensing provision would be effective for qualifying property placed in service in taxable years beginning after December 31, 1996.

Individual retirement arrangements (IRAs)

IRA plus accounts

The bill would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59-1/2 or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from normal IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. A special transition rule applies to rollovers made before June 30, 1993.

Penalty-free IRA withdrawals for qualified expenses

The bill would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home, certain education expenses, and certain medical expenses. Individuals also could withdraw funds to help children and grandchildren with a qualified expense.

Effective date

The provision would apply to taxable years beginning after December 31, 1991.

Passive loss rules

The bill would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of taxpayers engaged in the real property business. The provision would be effective with respect to taxable years beginning after December 31, 1991.

Enterprise zones

Tax provisions

The bill would authorize the Secretary of HUD to designate up to 50 enterprise zones over a four-year period. Zone designations generally would remain in effect for 25 years. With respect to the designated zones, the following tax incentives would apply:

Employment tax credit—A 5-percent refundable tax credit would be provided to certain enterprise zone employees for their first $10,500 of wages.

Capital gain exclusion—Long-term capital gain realized from the disposition of property (excluding collectibles) used in an enterprise zone business for at least two years would be excluded from income.

Deduction for enterprise zone stock—Individuals could elect to deduct up to $100,000 per year of the purchase price of certain enterprise zone stock, subject to a $500,000 lifetime limitation. The deduction would be treated as a preference item for alternative minimum tax purposes. A corporation could not issue more than $50 million of stock eligible for the deduction.

Non-tax provisions

The bill also contains the following non-tax provisions with respect to enterprise zones: (1) applications for establishment of a foreign trade zone within an enterprise zone would be processed on a priority basis; (2) the definition of a small entity would be expanded for purposes of the Regulatory Flexibility Act; and (3) Title VII of the Housing and Community Development Act of 1987 would be repealed.

Effective date

The enterprise zone tax provisions would be effective for taxable years ending after December 31, 1991. The non-tax provisions generally would be effective upon enactment.

11. S. 1921—"The Tax Fairness and Savings Incentive Act of 1991" (Senators Bentsen, Adams, Akaka, Baucus, Boren, Breaux, Burdick, Daschle, DeConcini, Dodd, Ford, Hatch, Inouye, Johnston, Lieberman, Mikulski, Pryor, Roth, and Symms)

Child refundable tax credit

The bill would provide a refundable tax credit equal to $300 for each child under age 19 residing with the taxpayer. The bill also would restore the pre-1986 deduction rules for contributions to individual retirement arrangements (IRAs) and create a new special IRA. Income on amounts contributed to special IRAs would not be includible in income if held in the special IRA for at least 5 years. Contribution limits for IRAs, special IRAs, and elective deferrals under certain other tax-favored arrangements would be coordinated. Individuals would be permitted to transfer amounts in IRAs to special IRAs. The bill would add exemptions to the 10-percent tax on early withdrawals for certain distributions for certain medical expenses, first-time home purchase, and education expenses.

Reduce defense spending

The bill would reduce defense spending in order to offset the cost of the bill's tax reduction provisions.

Effective date

The tax credit and IRA provisions generally would be effective for taxable years beginning after December 31, 1991, except that the new exceptions to the early withdrawal tax on IRAs would apply to distributions after the date of enactment.

12. S. 1865—"Defense Tax Rebate Act" (Senator Roth)

Individual income tax rates

Generally, the bill would reduce individual income tax rates except for high-income individuals. The rate reduction would be phased-in for taxable years 1992 through 1996. After taxable year

1996, the individual income tax rate structure would be composed of rates of 12 percent, 15 percent, 28 percent and 31 percent. The bill would also modify the withholding tables and procedures to reflect the lower tax rates.

The bill would be effective for taxable years beginning after December 31, 1991

Individual retirement arrangements (IRAs)

The bill would restore the deductibility of IRA contributions for all taxpayers under the rules in effect prior to the Tax Reform Act of 1986 and would index for inflation the limits on contributions to IRAs. In addition, the bill would create a new special IRA to which a taxpayer could make nondeductible contributions. Withdrawals from a special IRA would not be includible in income if attributable to contributions that had been held by the special IRA for at least 5 years. These provisions would be effective for taxable years beginning after December 31, 1991.

The bill would permit amounts in IRAs to be transferred to a special IRA. Amounts so transferred generally would be includible in income as if the amounts had been withdrawn from the IRA, except that the early withdrawal tax would not apply. In the case of transfers made before January 1, 1994, the amount includible in income is spread over the 4 taxable years following the transfer.

The 10-percent additional income tax on early withdrawals would not apply to withdrawals from an IRA and from elective deferrals under section 401(k) plan or tax-sheltered annuity to the extent the amount withdrawn is used for the purchase of a first home or for certain education or catastrophic medical expenses. This provision would be effective for payments and distributions made after the date of enactment.

Incremental investment tax credit

The bill would provide a 10-percent income tax credit for increasing the amount invested in new manufacturing and other productive equipment.

The bill would apply to property acquired by a taxpayer after December 31, 1991, and to the basis of property that is attributable to construction, reconstruction, or creation after December 31, 1991.

Modifications to social security benefits

Social security benefits are reduced for certain beneficiaries if they have wages or earned income in excess of a certain amount. The amount of the exemption depends on whether the beneficiary has attained retirement age. The bill would temporarily increase the otherwise applicable exempt amount for persons who have attained retirement age (i.e., 65 for 1991) by $3,000, and then would repeal the earnings test for individuals who have attained retirement age (rather than age 70). The benefit reduction of $1 for each $2 of earnings would then apply only to persons below retirement age, as under present law. The temporary increase in the exemption amount would be effective beginning in 1992, and the repeal of the earnings test for individuals who have attained retirement age would be effective in 1997.

The bill would also accelerate the increase in the delayed retirement credit so that it is 8 percent in 1993.

B. Personal Exemption; Standard Deduction; Child and Earned Income Tax Credits

1. H.R. 1277—Increase in Personal Exemption (Messrs. Wolf, Hastert, Dickinson, Lightfoot, Walsh, Cunningham, Ramstad, Klug, Hansen, Doolittle, Dornan of California, Weldon, Barrett, Smith of Texas, Cox of California, Holloway, McEwen, Bilirakis, and Inhofe)

The bill would increase the personal exemption for dependent children under the age of 18 to $3,500 in 1992, and would modify the rounding rules for indexed amounts. The bill would be effective for taxable years beginning after December 31, 1991.

2. H.R. 2633—Supplemental Young Child Tax Credit (Mr. Wolf)

The bill would replace the present-law supplemental young child component of the earned income tax credit with an expanded supplemental young child credit available to taxpayers with qualifying children under the age of five, effective for taxable years beginning after December 31, 1991.

3. H.R. 2714—Increase in Personal Exemption (Mr. Crane)

The bill would increase the personal exemption to $4,000, effective for taxable years beginning after December 31, 1990.

4. H.R. 3148—Increase in Personal Exemption for Certain Dependent Children; Change in Individual Income Tax Rates (Mrs. Schroeder)

The bill would increase the personal exemption for dependent children under the age of 18 to $3,500 in 1992, and modify the rounding rules for indexed amounts. The bill also would create a 36-percent rate for individuals and impose a surtax on higher-income individuals.

Generally, the bill would be effective for taxable years beginning after December 31, 1991.

5. H.R. 3202—"Tax Reduction and Simplification Act of 1991" (Messrs. Panetta, Kolten, Lipinski, and Lawrence Smith)

The bill would increase the basic standard deduction and would provide an additional standard deduction of $1,400 for each dependent for whom a taxpayer is allowed a personal exemption under present law. Both the basic standard deduction and the additional standard deduction would be indexed for future inflation. Also, the bill would reduce the amount of itemized deductions that are otherwise allowable for a taxable year by 10 percent (in addition to any present-law limitations).

The bill would be effective for taxable years beginning after December 31, 1991.

6. H.R. 3228—"Middle Class Tax Relief Act of 1991" (Ms. DeLauro, Messrs. Bonior, Gejdenson, and Frank, Ms. Pelosi, Messrs. Swett, Jefferson, Johnson of South Dakota, and Abercrombie)

Personal exemption

The bill would allow certain taxpayers an additional personal exemption amount of $1,000 (indexed for inflation) for themselves (and a spouse, in the case of a joint return) and for each dependent. The $1,000 additional exemption amount would be phased out for taxpayers with AGI in the following ranges (adjusted for inflation): $47,000 to $102,000 for married individuals filing joint returns; $37,000 to $87,300 for individuals filing as head of household; $28,000 to $61,000 for unmarried individuals filing single returns; and $23,500 to $51,000 for married individuals filing separate returns.

Individual and corporate income tax rates; surtax

As a revenue offset, the bill would: (1) provide for a new 36-percent individual income tax rate for taxable income in excess of $100,000 in the case of a joint return, $85,000 for a head of household, or $70,000 for a single individual (threshold amounts adjusted for inflation); (2) impose a 15-percent surtax on tax attributable to an individual's taxable income in excess of $225,000; (3) increase the individual alternative minimum tax rate from 24 percent to 27 percent; (4) impose a 2.5-percent surtax on the amount of alternative minimum taxable income in excess of $225,000; and (5) increase the top corporate tax rate from 34 percent to 36 percent.

Effective date

The bill would apply to taxable years beginning after December 31, 1991.

C. Capital Gains and Losses; Passive Losses; Investment Incentives

1. H.R. 246—Indexing of Capital Assets (Mr. Archer and others)

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1991).

In the case of stock in regulated investment companies and real estate investment trusts and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The bill would apply to dispositions after December 31, 1991, in taxable years ending after such date.

2. H.R. 248—Capital Gains Exclusion (Mr. Archer)

Under the bill, corporate and noncorporate taxpayers would be allowed a deduction equal to 30 percent of the net capital gains for the taxable year.

The bill generally would be effective for taxable years ending after the date of enactment.

3. H.R. 1414—Treatment of Certain Real Estate Activities Under the Limitations on Losses from Passive Activities (Messrs. Andrews, Thomas of California, Archer, Bunning, Matsui, Vander Jagt, Sundquist, Pickle, Jacobs, Chandler, Jenkins, Crane, Shaw, Grandy, Mrs. Johnson of Connecticut, Messrs. Anthony, Moody, Schulze, Rangel, Downey, Cardin, Dorgan, Guarini, and others)

The bill would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of taxpayers engaged in the real property business. This provision would be effective with respect to taxable years beginning after December 31, 1991.

4. H.R. 1445—"Rural Development Investment Zone Act of 1991" (Messrs. Dorgan, Grandy, and others)

Designation of rural development investment zones

The bill would authorize the Secretary of the Treasury to designate up to 100 rural development investment zones. Zone designations would remain in effect for up to 12 years.

Tax incentives for rural development investment zones

Wage tax credit.—The bill would provide to employers in rural development investment zones a 10-percent tax credit for certain wages paid to qualified employees. The credit would apply to only the amount of qualified wages paid during the taxable year which exceeds the amount of qualified wages paid during the preceding 12-month period. Qualified wages with respect to any qualified employee would be limited to 2.5 times the amount of wages subject to Federal unemployment (FUTA) tax (currently $7,000).

Investment tax credit.—The bill would provide a 10-percent tax credit for depreciable real property which in placed in service and located in (and used predominantly in the active conduct of a trade or business in) a rural development investment zone. The credit rate for new placed-in-service property would be phased out during the last several years that the designation of an area as a rural development investment zone remains in effect.

Effective date.—The wage tax credit would be effective for taxable years beginning after December 31, 1990. The investment tax credit generally would apply to property placed in service in periods after December 31, 1990.

Non-tax provisions

The bill would expand the definition of small entity for certain entities within rural development investment zones for purposes of the Regulatory Flexibility Act. In addition, the bill would require expedited processing of any application involving the establishment of a foreign trade zone within a rural development investment zone, and would require Federal agencies to provide special assistance to rural development investment zones to the extent permitted by law.

The non-tax provisions generally would be effective upon enactment.

5. H.R. 1721—"Capital Gains Tax Fairness Act of 1991" (Messrs. Dorgan and Johnson of South Dakota)

Lifetime capital gains deduction

The bill would provide individuals aged 25 or older with a deduction equal to 50 percent of their capital gains, up to a lifetime cap of $200,000 of gain. Assets eligible for the lifetime capital gains deduction would be capital assets held for more than one year, except collectibles and publicly traded assets (such as stock traded on a stock exchange).

Annual capital gains deduction

In addition to the lifetime capital gains deduction, the bill would provide individuals with a deduction of up to $1,000 of capital gains each year. The deduction would not be available to any individual who may be claimed as a dependent by another taxpayer. The deduction would be phased out for those with incomes between $100,000 and $150,000.

Assets eligible for the annual $1,000 capital gains deduction would be capital assets held for more than one year, including publicly traded assets, but not including collectibles. The annual $1,000 capital gains deduction would not count against the lifetime capital gains deduction and cap described above.

These capital gain deductions would not apply for purposes of computing alternative minimum taxable income.

Depreciation recapture

The bill also would provide that gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

Effective date

Both the lifetime capital gains deduction and the annual $1,000 capital gains deduction would apply to taxable years ending on or after April 11, 1991. The depreciation recapture provision would apply to dispositions of assets on or after April 11, 1991.

6. H.R. 2646—"The Productive Investment Incentive Act" (Mrs. Johnson, and Messrs. Guarini, Shays, Sharp, and Rhodes)

The bill generally would allow a taxpayer to expense and deduct up to $250,000 of the cost of certain tangible personal property that is for use as an integral part of manufacturing, production, or extraction.

The bill would be effective for taxable years beginning after December 31,1990.

7. H.R. 2873—"Economic Growth and Venture Capital Act of 1991" (Mr. Edwards of Oklahoma)

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent. The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill.

The bill would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion, and amortization would be determined without regard to the inflation adjustment.

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1990). In the case of stock in regulated investment companies and real estate investment trusts and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The bill would be effective for taxable years beginning after December 31, 1990.

8. H.R. 3514—Reduction in Capital Gains Rate and Indexing of Capital Assets (Mr. Crane)

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent. The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill.

The bill would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion, and amortization would be determined without regard to the inflation adjustment.

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1991). In the case of stock in regulated investment companies and real estate investment trusts and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets.

The provisions generally would apply to sales or exchanges occurring after December 31, 1991. The provision that would provide for the indexing of the limitation on capital losses would apply to tax years beginning after December 31, 1991.

9. H.R. 3652, Treatment of Certain Real Estate Activities Under the Passive Loss Rules; Capital Gains Exclusion for Individuals Based on the Period the Asset is Held (Mr. Shaw)

Passive loss limitation

The bill would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of taxpayers engaged in the real property business. This provision would be effective with respect to taxable years beginning after December 31, 1991.

Capital gains exclusion

The bill would allow individuals an exclusion of up to 30 percent of the gain realized on the disposition of capital assets. This provision would apply to sales and exchanges after September 30, 1991. For the portion of 1991 to which the proposal would apply, a 30-percent exclusion would apply for all assets held one year or more. For 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years.

10. H.R. 3741—"Enterprise Capital Formation Act of 1991" (Messrs. Matsui, Moody, Gradison, Markey, Hoagland, Pickle, Vander Jagt, Guarini, McGrath, Anthony, Chandler, Andrews of Texas, Mrs. Johnson of Connecticut, Mr. Bunning, and others)

Qualified small business net capital gain

The bill would provide taxpayers with a capital gain deduction with respect to dispositions of qualified small business stock. Taxpayers who have held qualified small business stock for more than five years would be allowed a deduction equal to 50 percent of their qualified small business net capital gain.

Qualified small business stock would be stock issued after December 31, 1991, acquired at original issue for money or as compensation for services. At the time of issue, the amount of money, the adjusted basis of property and the value of services received by the corporation for stock as a contribution to capital and as paid-in surplus, plus the accumulated earnings and profits of the corporation, could not exceed $100 million. In addition, the corporation must conduct an active business and use substantially all its assets in an active business during the 5-year period commencing with the acquisition of the stock.

The qualified small business capital gain deduction would be treated as a preference item under the alternative minimum tax.

Seed capital gain deduction

The bill also would provide taxpayers with a seed capital gain deduction with respect to dispositions of qualified small business stock in corporations with paid-in capital and surplus not in excess of $5 million. The deduction for seed capital gain would be on a sliding scale, depending on holding period: 50 percent for five to six years, 60 percent for six to seven years, 70 percent for seven to eight years, 80 percent for eight to nine years, 90 percent for nine to 10 years, and 100 percent for more than 10 years.

The seed capital gain deduction would not be treated as a preference item under the alternative minimum tax.

Section 1244 stock

The amount of money and other property that a small business corporation under section 1244 can receive for stock as a contribution to capital and as paid-in surplus would be increased from $1 million to $5 million.

Effective date

The bill would apply to stock issued after December 31, 1991. If a taxpayer holds appreciated stock that would have been treated as qualified small business stock at the time it was issued had these rules been in place, the taxpayer may elect to recognize all accrued gain with respect to such stock. In such event, any subsequent gains would be eligible for the qualified small business capital gain deduction or the seed capital gain deduction. The holding period for such stock would begin on the date the gain is recognized.

11. H.R. 3810—"The Investment Incentive and Recovery Act of 1991" (Messrs. Guarini and Levin)

The bill would provide a 7.5-percent income tax credit for increasing the amount invested in new manufacturing and other productive equipment for taxable years beginning after 1991. The credit would be allowed to offset 100 percent of the regular tax and alternative minimum tax liabilities of the taxpayer.

12. H.R. 3875—"Middle Income Tax Relief Act of 1991" (Messrs. Donnelly, Neal, and Mavroules)

The bill would provide individuals aged 25 or older with a deduction equal to 50 percent of their capital gains, up to a lifetime cap of $400,000 of gain. The bill also would impose a new maximum income tax rate of 34 percent on noncorporate taxpayers, and increase to 29 percent the alternative minimum tax rate applicable to such taxpayers.

13. H.R. 3945—Recognition of Losses on Sale of a Principal Residence (Mr. Archer)

The bill would provide that gains that would be recognized on the sale or exchange of a principal residence of a taxpayer are reduced (but not below zero) by the aggregate of the losses sustained by the taxpayer on the sale or exchange of prior principal residences of the taxpayer that were not previously taken into account. Only losses on sales or exchanges after December 31, 1990, would be taken into account. The bill would be effective for sales and exchanges after December 31, 1990.

14. H.R. 3979—Income Tax Credit for Payments or Contributions to Certain Cooperative Research Organizations (Mr. Levin)

Computation of credit

The bill would provide that taxpayers who make qualifying payments or contributions to a qualified cooperative research organization ("research cooperative") would be eligible for an income tax credit of up to 50 percent of the amount of such payments or contributions.

Under the bill, the amount of the credit would equal the taxpayer's qualified cooperative research expenditures incurred during the taxable year (of, if less, a portion of expenditures from three preceding years) multiplied by the applicable credit rate, which would vary for each recipient research cooperative, depending on the funding sources for that cooperative. A research cooperative that received its funding entirely from private, nongovernmental sources would have a maximum applicable percentage rate equal to 50 percent.

Qualified expenditures

Expenditures which would qualify for the credit generally would be cash payments or the fair market value of property or other inkind contributions (including the use of the taxpayer's real property, personal property, intangible property or employees) made to a qualified research cooperative, subject to various limitations.

Contributions qualifying for the credit would not include any amounts funded by a grant, contract, or otherwise by any governmental entity, and limitations would apply to contributions that are designated to a specific project.

Interaction with other provisions

The bill includes restrictions to prohibit taxpayers from claiming the credit provided for by the bill in addition to another credit or deduction under present-law provisions for the same research expenditure.

Effective date

The bill would be effective for taxable years beginning after the date of enactment.

D. Individual Retirement Arrangements; Homebuyers' Tax Credit

1. H.R. 519—Penalty-Free Withdrawals From IRAs, Etc. for Purchase of First Home (Mr. Thomas)

The bill would permit taxpayers to withdraw up to $10,000 from an IRA, section 401(k) plan, or tax-sheltered annuity plan for the purchase of a first home without the imposition of income tax or the 10-percent tax on early withdrawals. The $10,000 limit would be reduced for taxpayers with modified adjusted gross income above certain levels. The bill would also waive the 10-percent additional tax on distributions from IRAs, section 401(k) plans, and tax-sheltered annuities to pay for the first home of a child of the taxpayer, subject to the same limitations applicable to withdrawals to pay for the first home of the taxpayer (treating the child as the taxpayer).

2. H.R. 1406—"Savings and Investment Incentive Act of 1991" (Messrs. Pickle, Thomas, Andrews, Schulze, Mazzoli, and others)

The bill would restore the pre-1986 deduction rules for contributions to individual retirement arrangements (IRAs) and create a new special IRA. Amounts contributed to special IRAs would not be includible in income if held in the special IRA for at least 5 years. Contribution limits for IRAs and special IRAs would be coordinated. The bill would add exemptions to the 10-percent tax on early withdrawals for certain distributions for certain medical expenses, first-time home purchase, and education expenses. The bill would index the IRA deduction limit in $500 increments.

3. H.R. 3739—Tax Credit for the Purchase of a Principal Residence by a First-Time Homebuyer (Mrs. Johnson)

The bill would provide first-time homebuyers a nonrefundable tax credit equal to 5 percent of the purchase price of a principal residence with a maximum credit of $2,000, effective for purchases after the date of enactment.

E. Other Proposals

1. H.R. 710—"Tax-Exempt Bond Simplification Act of 1991" (Messrs. Anthony, Coyne, Guarini, Jacobs, Matsui, Moody, Shaw, Sundquist, and others)

Interest on State and local government bonds generally is excluded from income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units. Present law also excludes the interest on State and local government bonds ("private activity bonds") when a governmental unit incurs debt as a conduit to provide financing for private parties, if the financed activities are specified in the Internal Revenue Code (the "Code"). Tax-exempt bonds may not be issued to finance private activities not specified in the Code.

Issuers of all tax-exempt bonds generally are subject to two sets of arbitrage restrictions on investment of their bond proceeds. These restrictions are a yield restriction requirement, and a requirement that certain profits on nonpurpose investments be rebated to the Federal Government.

H.R. 710 would make numerous changes to the requirements governing issuance of tax-exempt bonds. Among the changes are: (1) repeal of a limit on unrelated and disproportionate private business use of governmental bond proceeds; (2) liberalization of the arbitrage yield restriction and rebate requirements; and (3) expansion of an exception from a financial institution interest deduction disallowance available to smaller governmental units.

The bill generally would be effective for bonds issued after December 31, 1990.

2. H.R. 951—"The Boating Industry Jobs Preservation" Act of 1991" (Messrs. Shaw, Vander Jagt, McGrath, Petri, Smith of Florida, Henry, Saxton, Machtley, Abercrombie, and Bonior)

The bill would repeal the luxury excise tax on boats, effective on January 1, 1991 (the date of imposition of the tax).

3. H.R. 2550—The Leading Employers into Apprentice "Partnerships Act" (Messrs. Grandy, Rangel, Houghton, and Morrison)

The bill would exempt apprenticeship education organizations from taxation. Apprenticeship education organizations would be organizations that are organized and operated solely for purposes of administering a qualified apprenticeship education program and that satisfy certain additional organizational tests.

The bill also would permit a 20-percent income tax credit for contributions made by businesses to any apprenticeship education organization. The deduction to employers for contributions to such organizations would not be reduced by the amount of the credit.

The bill would apply to years beginning after December 31, 1991.

4. H.R. 3651—Restoring the Exclusion From Gross Income for Income From Discharge of Qualified Real Property Business Indebtedness (Mr. Shaw)

For discharges of indebtedness on qualified real property, a taxpayer would be permitted to reduce the basis of depreciable assets rather than include the amount of discharge in gross income. Qualified real property indebtedness is, for a corporation, indebtedness incurred by the corporation in connection with any real property, or, for an individual, indebtedness incurred by the individual in connection with real property used in the individual's trade or business.

The bill would apply to discharges after December 31, 1991, in taxable years ending after that date.

II. DESCRIPTION OF PROPOSALS

A. Middle Income Tax Relief and Economic Growth Proposals

1. H.R. 3730, "The Middle Income Tax Relief and Fairness Act of 1992" (Messrs. Rostenkowski, Gephardt, Pease, Downey, Rangel, Matsui, Anthony, Dorgan of North Dakota, Donnelly, Coyne, Levin of Michigan, Cardin, McDermott, and others)

a. Social security payroll taxes

Present Law

Present law imposes a payroll tax to finance social security programs through the old-age, survivors, and disability insurance and hospital insurance trust funds (OASDI). As of January 1991, the employer and employee each pay an OASDI tax equal to 6.20 percent of the first $53,400 of covered earnings and an HI tax equal to 1.45 percent of the first $125,000 of covered earnings. Self-employed individuals pay tax at the combined employer-employee rate, but are permitted to deduct one-half of the payment as a business expense in determining their income tax liability. Present law provides no tax credit based on social security tax liability.

Explanation of Provision

The bill would provide a 20-percent refundable income tax credit in 1992 and 1993 based on an employee's social security tax liability. Generally, this is composed of the OASDI and HI tax liability of the employee only and not the employer portion (In the case of self-employed individuals, the base of the credit is the total OASDI and HI tax liability). The maximum credit would be $200 ($400 for married couples filing joint returns). The credit would not reduce social security reserves.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991.

b. Individual income tax rates

Present Law

For 1991, the individual tax rate schedules are—

If taxable income is	Then income tax equals
Single individuals	
$0–$20,350	15 percent of taxable income.
$20,350–$49,300	$3,052.50 plus 28% of the amount over $20,350.
Over $49,300	$11,158.50 plus 31% of the amount over $49,300.
Heads of households	
$0–$27,300	15 percent of taxable income.
$27,300–$70,450	$4,095 plus 28% of the amount over $27,300.
Over $70,450	$16,177 plus 31% of the amount over $70,450.
Married individuals filing joint returns	
$0–$34,000	15 percent of taxable income.
$34,000–$82,150	$5,100 plus 28% of the amount over $34,000.
Over $82,150	$18,582 plus 31% of the amount over $82,150.
Married individuals filing separate returns	
$0–17,000	15 percent of taxable income.
$17,000–$41,075	$2,550 plus 28% of the amount of 17,000.
Over $41,075	$9,291 plus 31% of the amount over $41,075.
Trusts and estates	
$0–$3,450	15 percent of taxable income.
$3,450–$10,350	$517.50 plus 28% of the amount over $3,450.
Over $10,350	$2,449.50 plus 31% of the amount over $10,350.

Explanation of Provision

The bill would create a 35-percent bracket for taxable incomes above: $85,000 (unmarried individuals filing single returns); $125,000 (unmarried individuals filing as heads of households); $145,000 (married individuals filing joint returns); $72,500 (married individuals filing separate returns); and $7,000 (estates and trusts). As adjusted for inflation, the individual rate schedules for 1992 would be—

If taxable income is	Then income tax equals
Single individuals	
$0–$21,600	15 percent of taxable income.
$21,600–$52,250	$3,240 plus 28% of the amount over $21,600.
$52,250–$85,000	$11,822 plus 31% of the amount over $52,250.
Over $85,000	$21,974.50 plus 35% of the excess over $85,000.
Heads of households	
$0–$28,900	15 percent of taxable income.
$28,900–$74,650	$4,335 plus 28% of the amount over $28,900.
$74,650–$125,000	$17,145 plus 31% of the amount over $74,650.
Over $125,000	$32,753.50 plus 35% of the excess over $125,000.
Married individuals filing joint returns	
$0–$36,000	15 percent of taxable income.
$36,000–$87,050	$5,400 plus 28% of the amount over $36,000.
$87,050–$145,000	$19,694 plus 31% of the amount over $87,050.
Over $145,000	$37,658.50 plus 35% of the excess over $145,00.
Married individuals filing separate returns	
$0–$18,000	15 percent of taxable income.
$18,000–$43,525	$2,700 plus 28% of the amount over 18,000.
$43,525–$72,500	$9,847 plus 31% of the amount oer $43,525.
Over $72,500	$18,829.25 plus 35% of the excess over $72,000.
Trusts and estates	
$0–$3,000	15 percent of taxable income.
$3,000–$5,000	$450 plus 28% of the amount over $3,000.
$5,000–$7,000	$1,010 plus 31% of the amount over $5,000.
Over $7,000	$1,630 plus 35% of the excess of $7,000.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991.

c. Individual minimum tax

An individual taxpayer is subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent and is applied to the taxpayer's alternative minimum taxable income (generally computed by adding preference items to the taxpayer's regular taxable income).

Explanation of Provision

The bill would increase the alternative minimum tax rate on individuals from 24 percent to 25 percent.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991.

d. Surtax on higher-income individuals

Present Law

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

Explanation of Provision

The bill would apply a 10-percent surtax on individuals (including estates and trusts) with taxable income over $1,000,000 ($500,000 for married taxpayers filing separate returns).

A 2.5-percent surtax would apply to AMT income above $1,000,000 ($500,000 for married taxpayers filing separate returns).

The surtaxes would apply to the 28-percent rate applicable to capital gains income.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991.

e. Budget provision

Present Law

The 1990 Budget Act substantially amended the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings). In relevant part, the 1990 Budget Act provides for an automatic sequester of non-exempt spending programs to avoid any Federal deficit increase if increases in direct spending or reductions in revenue are not paid for on a year-by-year basis ("pay-as-you-go").

Explanation of Provision

The bill would be exempted from the pay-as-you-go procedures of the Balanced Budget and Emergency Deficit Control Act of 1985 as amended by the 1990 Budget Act.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991.

2. "The Economic Growth, Investment and Job Creation Act"

(House Republican Conference)

a. capital gains and losses

Present Law

Sale or exchange of capital assets

In general.—Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of certain depreciation, depletion, etc. recapture) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Section 1244 stock.—A loss recognized by an individual on section 1244 stock which otherwise would be treated as a capital loss is treated as an ordinary loss, subject to a limit of $50,000 for any taxable year ($100,000 in the case of a joint return). Section 1244 stock is stock in a domestic corporation if the corporation is a small business corporation, the stock is issued for money or other property (other than stock and securities), and the corporation derived more than 50 percent of its aggregate gross receipts during its past five taxable years from sources other than royalties, rents, dividends, interest, annuities, and sales or exchanges of stocks or securities. A corporation is treated as a small business corporation if the aggregate amount of money and other property received for stock, as a contribution to capital and as paid-in surplus, does not exceed $1 million.

No indexing.—The amount taken into account under present law in computing gain or loss from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for gains reflecting inflationary increases in the value of the asset.

Gain or loss on the sale of principal residence

Under present law, taxpayers generally may claim as a deduction any loss sustained during the taxable year and not compensated by insurance or otherwise. In the case of an individual, however, the deduction is limited to (1) losses incurred in a trade or business, (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business, and (3) catastrophic losses of property that arise from fire, storm, shipwreck, or other casualty, or from theft. Deductions for losses from the sale or exchange of capital assets are subject to the limitations described above.

A loss on the sale of a principal residence is treated as a nondeductible personal loss rather than a deductible capital loss. A gain on the sale of a principal residence is treated as a capital gain, and is taxed at a maximum rate of 28 percent. However, if an individual purchases a new principal residence within 2 years of selling the old residence, gain from the sale of the old residence (if any) is recognized only to the extent that the taxpayer's adjusted sales price exceeds the taxpayer's cost of purchasing the new residence (Code sec. 1034). A taxpayer also may elect to exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale, and (2) has used the residence as a principal residence for three or more years of the five years preceding sale of the residence (sec. 121). The election may be made only once.

Explanation of Proposals

Reduction of capital gains tax rate for individuals

The proposal would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held three years or more would qualify for a 30-percent exclusion; assets held at least two years but less than three years would qualify for a 20-percent exclusion; and assets held at least one year but less than two years would qualify for a 10-percent exclusion. For a taxpayer whose capital gains would otherwise be subject to a 28-percent rate, this would result in a tax rate on capital gains of 19.6 percent for assets held three years or more, 22.4 percent for assets held between two and three years, and 25.2 percent for assets held between one and two years. Likewise, for a taxpayer in the 15-percent bracket, the result would be a tax of 10.5 percent, 12 percent, and 13.5 percent for assets held three, two, and one years respectively.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded.

The capital gains exclusion would be a preference for purposes of the alternative minimum tax.

Capital gains treatment of venture capital investments

Qualified small business net capital gain.—The proposal would provide taxpayers with a capital gain deduction with respect to dispositions of qualified small business stock. Taxpayers who held qualified small business stock for more than five years would be allowed a deduction equal to 50 percent of their qualified small business net capital gain. A maximum rate of 14 percent would apply to such gains recognized by individuals; a maximum 17 percent rate would apply for corporations.

Qualified small business stock would be stock issued after December 31, 1991,[2] acquired at original issue for money or as compensation for services. At the time of issue, the amount of money, the adjusted basis of property and the value of services received by the corporation for stock as a contribution to capital and as paid-in surplus, plus the accumulated earnings and profits of the corporation, could not exceed $100 million (as indexed for inflation). In addition, the corporation would have to conduct an active business and use substantially all its assets in an active business during the 5-year period commencing with the acquisition of the stock.[3] Certain start-up activities, activities resulting in research and experimental expenditures, computer software royalties and working capital would count towards the active business test. However, a corporation would not satisfy the active business test if more than 10 percent of its assets consisted of portfolio stock investments or real property not used in an active trade or business.

Stock acquired by the taxpayer through the exercise of certain options or warrants, or through the conversion of convertible debt, would be treated as acquired at original issue, and as having been held during the period such option, warrant or debt was held.

If property (other than money or stock) is transferred to a corporation for stock, the basis of the stock received would be treated as equal to the fair market value of the property exchanged. Thus, for example, only gains that accrue subsequent to the transfer would be eligible for the capital gains deduction.

The qualified small business capital gain deduction would be treated as a preference item under the alternative minimum tax.

Seed capital gain deduction.—In addition to a deduction for qualified small business net capital gain, the proposal also would provide taxpayers with a seed capital gain deduction with respect to dispositions of qualified small business stock in corporations with paid-in capital and surplus not in excess of $5 million (as indexed for inflation). The deduction for seed capital gain would be on a sliding scale, depending on holding period: 50 percent for more than five years to six years, 60 percent for more than six years to seven years, 70 percent for more than seven years to eight years, 80 percent for more than eight years to nine years, 90 percent for

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[2] Anti-abuse rules would be provided to prevent corporations from redeeming stock issued before the effective date and reissuing stock after the effective date in order to qualify for the capital gains deduction.

[3] A corporation that owned at least 50 percent of a subsidiary would be deemed to own its ratable share of the subsidiary's assets and to conduct its ratable share of the subsidiary's activities.

more than nine years to 10 years, and 100 percent for more than 10 years.

A maximum 14 percent rate would apply to seed capital gains recognized by individuals; the maximum rate would be 17 percent for corporations.

The seed capital gain deduction would not be treated as a preference item under the alternative minimum tax.

Section 1244 stock.—The amount of money and other property that a small business corporation could receive for stock as a contribution to capital and as paid-in surplus would be increased from $1 million to $5 million, and would be adjusted for inflation.

Indexing of certain assets for purposes of determining capital gain or loss

In general.—The proposal generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

Indexed assets.—The proposal generally would provide for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock and certain foreign stock.[4]

Computation of inflation adjustment.—The inflation adjustment under the proposal would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1993) (the "applicable inflation ratio"). The applicable inflation ratio would not be taken into account unless it is greater than one. In addition, it would be rounded to the nearest one-tenth of one percent. The indexed basis would be the adjusted basis of the asset, multiplied by the applicable inflation ratio.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset would not be taken into account. For example, if convertible debt was converted into common stock, the period prior to conversion would be disregarded in determining the inflation ratio applicable to the disposition of the common stock. In addition, an asset would not be treated as an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

To the extent that an ordinary loss would be created or increased by the proposal, the taxpayer would be treated as having a long-

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[4] Stock in a foreign corporation that is listed on a domestic exchange generally would be treated as an indexed asset.

term capital loss in an amount equal to the amount of the ordinary loss.

The indexing adjustment generally would not apply to dispositions between related parties. In addition, if the principal purpose of a transfer is to increase an indexing adjustment, the adjustment may be disallowed.

The indexing adjustment would apply for purposes of determining earnings and profits.

Special entities.—In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs) and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio generally would be determined every month. Where the ratio of indexed assets to total assets exceeded 90 percent in any month, full indexing of the stock would be allowed for that month. Where less than 10 percent of the assets were indexed assets in any month, no indexing would be allowed that month for the stock.

In the case of partnerships, inflation adjustments made at the partnership level would be passed through to the partners.

Loss on the sale of principal residence treated as a capital loss

The proposal would provide that losses from the sale or exchange of a principal residence would be treated as a capital loss.

Effective Dates

Reduction of capital gains tax rate for individuals

The proposal would apply to sales and exchanges after September 30, 1991. For sales or exchanges in 1991, a 30-percent exclusion would apply for all assets held one year or more. For sales or exchanges in 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years.

Fifty-percent capital gains exclusion on venture capital investments

The proposal would apply to stock issued after December 31, 1991. If a taxpayer holds appreciated stock that would have been treated as qualified small business stock at the time it was issued had these rules been in place, the taxpayer could elect to recognize all accrued gain with respect to such stock. In such event, any subsequent gains would be eligible for the qualified small business capital gain deduction or the seed capital gain deduction. The holding period for such stock would begin on the date the gain is recognized.

Indexing of certain assets for purposes of determining capital gain or loss

The proposal would apply to dispositions after December 31, 1993.

Loss on the sale of principal residence treated as a capital loss

The proposal would be effective for sales and exchanges after December 31, 1991.

b. Election by small businesses to expense certain depreciable property

Present Law

A taxpayer generally may elect to deduct the cost of up to $10,000 of qualifying property for the taxable year in which the property is placed in service, in lieu of recovering such amount through depreciation deductions over the recovery period specified for the property. For this purpose, qualifying property generally is defined as depreciable tangible property that is purchased for use in the active conduct of a trade or business.

The amount eligible to be expensed for any taxable year is reduced by the amount by which the cost of qualifying property placed in service during the year exceeds $200,000. In addition, the amount eligible to be expensed may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct by the taxpayer of any trade or business (determined without regard to the expensing allowance). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

Explanation of Proposal

The proposal would increase the amount eligible to be expensed for any taxable year from $10,000 to $18,200 for qualifying property that is purchased for use as an integral part of manufacturing, production, or extraction. In addition, the proposal would increase the $200,000 phase-out threshold to $1 million for qualifying property that is purchased for use as an integral part of manufacturing, production, or extraction. The proposal would also provide that the expensing election applies for purposes of the alternative minimum tax.

Effective Date

The proposal would apply to taxable years beginning after December 31, 1991.

c. Increase social security earnings limitation

Present Law

Social security benefits are reduced for certain beneficiaries if they have wages or earned income in excess of a certain amount. For 1991, the exempt amount in the case of beneficiaries under age 65 is $7,080. For such beneficiaries, benefits are reduced by $1 for each $2 of wages or earnings in excess of the exempt amount. For 1991, the exempt amount in the case of beneficiaries age 65-69 is $9,720, and benefits are reduced for such beneficiaries by $1 for each $3 of wages or earnings in excess of the exempt amount. The reduction does not apply to beneficiaries age 70 or older. The exempt amounts are adjusted each year for inflation.

Explanation of Proposal

The proposal would increase the exempt amount $1,000 per year over a period of 5 years, beginning after 1991. The proposal also appropriates funds to pay for the increases in benefits under the provision. Sufficient funds to pay the increase in benefits are to be transferred at least quarterly from the general funds of the Treasury to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The Secretary of the Treasury is to report annually to the Congress and the Secretary of Health and Human Services on the transfers made during the year and the anticipated operation of the provision during the next 5 years.

Effective Date

The proposal would apply to taxable years ending after 1991.

d. Modify passive loss rules

Present Law

Under present law, the passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. Deductions that are suspended under this rule are carried forward and treated as deductions from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate, and rental activities. A rental activity is treated as a passive activity, regardless of the level of the taxpayer's participation, material or otherwise. (A special rules permits the deduction of up to $25,000 of losses from certain rental real estate activities, even though they are considered passive, for taxpayers with adjusted gross incomes of $100,000 or less. This deduction is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000.)

Explanation of Proposal

The proposal would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of individual and corporate taxpayers "engaged in the real property business". Rental real property activities would be treated the same as nonrental activities, for purposes of determining what is an activity and whether an activity is passive. Under the proposal, the taxpayer's material participation in a rental real property activity (or aggregated real property activities) would determine whether losses and credits therefrom are passive and are subject to the limitation of the passive loss rule. Rental activities involving property other than real property would continue to be treated as passive as under present law, regardless of whether the taxpayer materially participates in them.

The proposal would provide that a individual is engaged in the real property business if the taxpayer spends at least 50 percent of his working time and more than 500 hours a year in real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, brokerage, appraisal or finance operations. Whether a corporation is engaged in the real property business is determined by the involvement of shareholders or employees in the real property activities of the corporation.

Effective Date

The proposal would be effective with respect to taxable years beginning after December 31, 1991. Thus, the provisions of the proposal would apply to activities acquired by the taxpayer on or before December 31, 1991, as well as those acquired after that date.

e. Leading employers into apprentice programs ("LEAP")

Present Law

Code section 501(c)(3) lists certain types of organizations that are exempt from taxation, including those "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes. . . ." Charitable contributions to these organizations are deductible under Code section 170, subject to certain percentage limitations. Payments to these organizations that are ordinary and necessary business expenses are deductible under Code section 162.

Present law provides no special tax incentive for apprenticeship programs.

Explanation of Proposal

Tax exemption

The proposal would specifically exempt apprenticeship education organizations from taxation. Apprenticeship education organizations would be organizations that were organized and operated solely for purposes of administering a qualified apprenticeship education program and that satisfied certain additional organizational tests. A qualified apprenticeship education program would be a program which:

(1) was operated in conjunction with local school systems, community colleges, and trade schools;

(2) placed "qualified students" in local apprenticeship positions related to the courses of study of the students;

(3) established restrictions on the work that may be performed by the students to ensure that the work is appropriate to the educational objectives of the program;

(4) limited each student to 20 hours of work a week as an apprentice;

(5) required the students to be paid at no more than minimum wage; and

(6) restricted the number of students that are related to contributors to the organization.

"Qualified students" would be (a) full-time students in a high school or community college and (b) part-time students in a graduate equivalency degree program or community college who are age 18 or older.

Tax credit

The proposal also would permit a 20-percent income tax credit for contributions made by businesses to any apprenticeship education organization. The deduction to employers for contributions to such organizations would not be reduced by the amount of the credit.

Effective Date

The proposal would apply to years beginning after December 31, 1991.

f. Individual retirement arrangements (IRAs)

Present Law

In general

Under certain circumstances, an individual is allowed a deduction for contributions (within limits) to an individual retirement account or an individual retirement annuity (an IRA) (Code sec. 219). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA.

Under present law, the maximum deductible contribution that can be made to an IRA generally is the lesser of $ 2,000 or 100 percent of an individual's compensation (earned income in the case of self-employed individuals). In addition, a married taxpayer who files a joint return with his or her spouse can make an additional contribution of up to $250 to an IRA established for the benefit of the spouse, if the spouse has no compensation or elects to be treated as having no compensation. A single taxpayer is permitted to make the maximum deductible IRA contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has adjusted gross income (AGI) of less than $25,000. A married taxpayer filing a joint return is permitted to make the maximum deductible IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married couple) is an active participant in an employer-sponsored retirement plan, the maximum IRA deduction is phased out over certain AGI levels. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Nondeductible IRA contributions

Individuals may make nondeductible IRA contributions to the extent deductible contributions are not allowed because of the AGI phaseout and active participant rules. A taxpayer may also elect to make nondeductible contributions in lieu of deductible contributions. Thus, any individual may make nondeductible contributions up to the excess of (1) the lesser of $2,000 or 100 percent of compensation over (2) the IRA deduction claimed by the individual. An individual making nondeductible contributions is required to report the amount of such contributions on his or her tax return. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions are not subject to income tax until withdrawn.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than amounts that represent a return of nondeductible contributions) are includible in income when withdrawn. If an individual withdraws an amount from an IRA during a taxable year and the individual has previously made both deductible and nondeductible IRA contributions, then the amount includible in income for the taxable year is the excess of the amount withdrawn over the portion of the amount withdrawn attributable to investment in the contract (i.e., nondeductible contributions). The amount attributable to nondeductible contributions is the portion of the amount withdrawn that bears the same ratio to the amount withdrawn as the total amount of nondeductible contributions bears to the total current value of all IRAs of the individual.

Withdrawals from an IRA prior to age 59½, death, or disability are generally subject to an additional 10-percent income tax (sec. 72(t)). The 10-percent additional income tax is intended to recapture at least a portion of the tax benefit of the IRA. The 10-percent additional income tax does not apply to withdrawals that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of the taxpayer and the taxpayer's designated beneficiary. A similar early withdrawal tax applies to withdrawals from qualified retirement plans and deferred annuities.

Explanation of Proposal

IRA plus accounts

The proposal would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996. In the case of married taxpayers, each spouse could contribute up to $2,000 if the combined compensation of the spouses was at least as great as the IRA plus contributions. Contributions could be made by an individual to an IRA plus account after the individual reaches age 70½.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59½ or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from normal IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. Balances originating from qualified retirement plans other than IRAs could not be rolled over into an IRA plus account. In the case of a rollover from a normal IRA made on or before the earlier of (1) the date the individual attains age 55, or (2) June 30, 1993, the tax on the includible amount of the rollover would be spread ratably over the 4-taxable year period beginning with the taxable year in which the amount was paid out of the IRA. Amounts that are rolled over could not be distributed tax-free until 5 years after the date of the rollover.

Penalty-free IRA withdrawals for first-time home buyers

The proposal would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home. Amounts in excess of the 25 percent limit would be subject to income tax, but would not be subject to the additional 10-percent tax on early withdrawals. The proposal would apply to individuals who did not own a home in the last 3 years. Individuals also could withdraw funds to help children and grandchildren purchase a first home.

The basis of the home purchased with the proceeds of a tax-free IRA distribution would be reduced by the amount excluded from income. Upon sale of the home, gain up to the amount of the excludable distribution would be treated as ordinary income and the 10-percent tax on early withdrawals would apply except to the extent such gain is rolled over into an IRA.

Effective Dates

IRA plus accounts

The IRA plus proposal would apply to taxable years beginning after December 31, 1991.

Penalty-free IRA withdrawals for first-time home buyers

The penalty-free IRA withdrawal proposal would apply to taxable years beginning after December 31, 1991.

g. Interest exclusion for middle income taxpayers

Present Law

Under present law, gross income generally includes interest and dividends received during the taxable year by an individual. Gross income generally does not include interest from general obligation bonds issued by State and local governments.

Explanation of Proposal

The proposal would exclude from gross income the first $225 of interest received ($450 in the case of a joint return). The amount of the exclusion available would be phased out for taxpayers with adjusted gross income (AGI) in the range of $50,000-$60,000 ($25,000-$35,000 for married, filing separately).

Nonresident aliens would be eligible for the exclusion only if the interest was earned in connection with a trade or business in the U.S. or if they are subject to the alternative tax for expatriates under Code section 877.

Interest on borrowing would not be excludible to the extent that the borrowed funds were used to obtain assets yielding excludible interest under this proposal. (This is similar to the current rule regarding borrowing to obtain assets yielding tax-free interest.)

Some fraction of the dividends from real estate investment companies (RICs) and real estate investment trusts (REITs) may be treated as interest for the purposes of this proposed exclusion. In the case of a RIC, if the aggregate interest received by the RIC is at least 75 percent of the entity's gross income (calculated less deductions for interest paid and less gains from the sales of securities), then all of the dividend is treated as interest. If the percentage is less than 75, then only that percentage of the dividends is treated as interest.

In the case of a REIT, if the aggregate interest received by the REIT is at least 75 percent of the entity's gross income (calculated less deductions for interest paid (other than on mortgages on real property owned by the REIT) and less net capital gain), then all of the dividend is treated as interest. If the percentage is less than 75, then only that percentage of the dividends is treated as interest.

Effective Date

The proposal would apply with respect to taxable years beginning after December 31, 1991.

h. Repeal the luxury excise taxes

Present Law

General rules

Present law imposes a 10-percent excise tax on the portion of the retail price of the following items that exceeds the thresholds specified:

Boats and yachts above $100,000.—The tax applies to pleasure boats and yachts above $100,000. Boats and yachts that are used exclusively (other than a de minimis amount) in a trade or business (other than for entertainment or recreation purposes, including the trade or business of providing entertainment or recreation) are exempt from this tax. In addition, boats and yachts that are used exclusively in the trade or business of commercial fishing or of transporting persons or property for compensation or hire are exempt from this tax. The transporting of persons or property for compensation or hire includes transportation by a cruise ship (regardless of destination) or by a boat chartered with a pilot.

Automobiles above $30,000.—The tax applies to passenger automobiles, which includes trucks and vans with a loaded gross vehicle weight of 6,000 pounds or less. Limousines are subject to this tax regardless of weight. The tax does not apply to the sale or leasing of any passenger vehicle for use by the purchaser or lessee exclusively (other than a de minimis amount) in the active conduct of a trade or business of transporting persons or property for compensation or hire.

Aircraft above $250,000.—The tax applies to aircraft above $250,000, with exceptions for aircraft 80 percent of the use of which is in a trade or business, and certain other uses.

Jewelry above $10,000.—The tax applies on an item-by-item basis. Custom fabrication of jewelry (from new or used materials) also is subject to this tax. Repairs and slight modifications to jewelry are not subject to this tax.

Furs above $10,000.—The tax applies to items made from fur or in which fur is a major component. The tax does not apply to leather or to artificial fur.

Effective date of taxes

The luxury excise taxes were enacted as part of the Omnibus Budget Reconciliation Act of 1990, which included increases in the rates of several existing excise taxes. The luxury excise taxes apply to sales after December 31, 1990, and before January 1, 2000.

Explanation of Proposal

The excise taxes on luxury items would be repealed.

Effective Date

The repeal would be effective on the date of enactment.

3. H.R. 960, "Economic Growth and Jobs Creation Act of 1991" (Messrs. DeLay, Tallon, Darden, Armey, Ballenger, Boehner, Cox, Dannemeyer, Doolittle, Hancock, Herger, Riggs, Weber, and others)

a. Social Security Taxes

Present Law

Social security benefits are financed by payroll taxes on covered wages and income taxes imposed on social security benefits of higher-income taxpayers. In 1991, employers and employees each pay an old-age, survivor, and disability income (OASDI) tax equal to 6.2 percent of the first $53,400 of covered wages. Similarly, self-employed persons pay a tax on self-employment income up to $53,400 at the combined employer-employee rate of 12.4 percent. Self-employed individuals are permitted to deduct one-half of their social security taxes in determining income tax liability.

Explanation of Provisions

The bill would lower the OASDI rate for employers and employees from 6.2 percent to 5.3 percent, and the corresponding tax rate for self-employed individuals from 12.4 percent to 10.6 percent. The bill would also modify the procedures of the House for changing OASDI taxes and benefits.

Effective Date

The decrease in the OASDI rate for employers and employees would be effective for remuneration received or paid after June 30, 1991, and the change in the self-employment tax would apply to taxable years beginning after June 30, 1991.

b. Capital gains, indexing, depreciation, and expensing

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income, i.e., 34 percent.

Capital losses are deductible generally only to the extent of capital gains, although individual taxpayers may deduct up to an additional $3,000 of capital losses against ordinary income in any year ($1,500 in the case of a married individual filing a separate return). Individuals may carry over capital losses in excess of this limit to future years indefinitely.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Personal exemption and itemized deduction phaseouts

The deduction for personal exemptions is phased out for taxpayers with adjusted gross incomes (AGIs) above a threshold amount. In addition, the total of otherwise allowable miscellaneous itemized deductions that may be claimed by a taxpayer generally is reduced for taxpayers with AGIs above a threshold amount.

Alternative minimum tax

Taxpayers are subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent (20 percent in the case of corporations) and is applied to the taxpayer's alternative minimum taxable income (generally computed by making adjustments and adding preference items to the taxpayer's regular taxable income).

Indexing

The amount taken into account under present law in computing gain or loss from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Depreciation deductions

A taxpayer is allowed depreciation deductions for the cost of property used in a trade or business. The amount of the depreciation deduction allowed with respect to the cost of any tangible property for a taxable year is determined under the accelerated cost recovery system (ACRS) as modified by the Tax Reform Act of 1986. Under ACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods generally applicable to tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

Expensing election

In lieu of depreciation, a taxpayer may elect to expense and deduct up to $10,000 of the cost of qualifying property placed in service for the taxable year. For this purpose, qualifying property generally is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $10,000 amount is reduced by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

Explanation of Provisions

Capital gains

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent.

For purposes of computing a taxpayer's personal exemption and itemized deduction phaseouts, the taxpayer's AGI would be reduced by any net capital gain.

The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill. The adjustment would equal the percentage by which the GNP deflator for the last calendar quarter of the preceding calendar year exceeds the GNP deflator for the last calendar quarter of 1990.

Indexing

In general

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

Indexed assets

The bill generally would provide for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock.[5]

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending June 30, 1991) (the "applicable inflation ratio"). The applicable inflation ratio would not be taken into account unless it is greater than one. In addition, it would be rounded to the nearest one-tenth of one percent. The indexed basis would be the adjusted basis of the asset, multiplied by the applicable inflation ratio.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset would not taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion would be disregarded in determining the inflation ratio applicable to the disposition of the common stock. In addition, an asset would not be treated as an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

To the extent that an ordinary loss would be created or increased by the provision, the taxpayer would be treated as having a long-term capital loss in an amount equal to the amount of the ordinary loss.

The indexing adjustment generally would not apply to dispositions between related parties. In addition, if the principal purpose of a transfer is to increase an indexing adjustment or a depreciation deduction, the adjustment may be disallowed.

The indexing adjustment would apply for purposes of determining earnings and profits.

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[5] Stock in a foreign corporation that is listed on a domestic exchange generally would be treated as an indexed asset.

Special entities

In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs) and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio generally would be determined every month. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock would be allowed for that month. Where less than 10 percent of the assets are indexed assets in any month, no indexing would be allowed that month for the stock.

In the case of partnerships and S corporations, inflation adjustments made at the partnership and S corporation levels would be passed through to the partners and shareholders.

Depreciation adjustment for certain property placed in service in taxable years beginning after 1990

Under the bill, in the case of tangible property (other than residential rental property and nonresidential real property) placed in service in a taxable year beginning after 1990, the deduction allowed under ACRS for any taxable year after the year in which the property is placed in service would be determined by multiplying the depreciation allowance allowable for the property for the taxable year (determined without regard to this provision) by the "applicable neutral cost recovery ratio" for the year.

The applicable neutral cost recovery ratio for the year would be first determined by dividing (1) the gross national product deflator for the calendar quarter ending in such taxable year which corresponds to the calendar quarter during which the property was placed in service by the taxpayer by (2) the gross national product deflator for the calendar quarter during which the property was placed in service by the taxpayer. This ratio would then be multiplied by the number equal to 1.035 to the nth power, where "n" is the number of full years in the period beginning on the first day of the calendar quarter during which the property was placed in service and ending on the day before the beginning of the corresponding calendar quarter ending during the taxable year. The applicable neutral cost recovery ratio could not be less than 1 and would be rounded to the nearest one-tenth of one percent.

Phase in of expensing for certain property placed in service in taxable years beginning after 1996

Under the bill, in the case of tangible property placed in service in a taxable year beginning after 1996, the taxpayer would be allowed to (1) deduct "phase-in deductions" for the year such property is placed in service and (2) reduce the applicable recovery period for such property by the "phase-in number of years." The "phase-in deductions" with respect to any property would be the aggregate deductions allowed under ACRS (determined without regard to this provision and the indexing provision described above) for the first phase-in number of years in the applicable recovery period. The "phase-in number of years" with respect to any property would be the number of calendar years after 1996 and before the calendar year in which the property is placed in service.

These phase-in provisions would not apply to any property for which the taxpayer so elects. Any election, once made, is irrevocable.

Effective Dates

Capital gains and indexing

The provisions would generally apply to sales or exchanges occurring after June 30, 1991. The provision that would provide for the indexing of the limitation on capital losses would apply to taxable years beginning after December 31, 1991.

Depreciation and expensing

The depreciation provision of the bill would be effective for qualifying property placed in service in taxable years beginning after December 31, 1990. The phase-in expensing provision of the bill would be effective for qualifying property placed in service in taxable years beginning after December 31, 1996.

c. Individual retirement arrangements; taxation of social security benefits

Present Law

Individual retirement arrangements (IRAs)

In general

Under certain circumstances, an individual is allowed a deduction for contributions (within limits) to an individual retirement account or an individual retirement annuity (an IRA) (Code sec. 219). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA.

Under present law, the maximum deductible contribution that can be made to an IRA generally is the lesser of $ 2,000 or 100 percent of an individual's compensation (earned income in the case of self-employed individuals). In addition, a married taxpayer who files a joint return with his or her spouse can make an additional contribution of up to $250 to an IRA established for the benefit of the spouse, if the spouse has no compensation or elects to be treated as having no compensation. A single taxpayer is permitted to make the maximum deductible IRA contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has adjusted gross income (AGI) of less than $25,000. A married taxpayer filing a joint return is permitted to make the maximum deductible IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married couple) is an active participant in an employer-sponsored retirement plan, the maximum IRA deduction is phased out over certain AGI ranges. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Nondeductible IRA contributions

Individuals may make nondeductible IRA contributions to the extent deductible contributions are not allowed because of the AGI phaseout and active participant rules. A taxpayer may also elect to make nondeductible contributions in lieu of deductible contributions. Thus, any individual may make nondeductible contributions up to the excess of (1) the lesser of $2,000 or 100 percent of compensation over (2) the IRA deduction claimed by the individual. An individual making nondeductible contributions is required to report the amount of such contributions on his or her tax return. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions are not subject to income tax until withdrawn.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than amounts that represent a return of nondeductible contributions) are includible in income when withdrawn. If an individual withdraws an amount from an IRA during a taxable year and the individual has previously made both deductible and nondeductible IRA contributions, then the amount includible in income for the taxable year is the excess of the amount withdrawn over the portion of the amount withdrawn attributable to investment in the contract (i.e., nondeductible contributions). The amount attributable to nondeductible contributions is the portion of the amount withdrawn that bears the same ratio to the amount withdrawn as the total amount of nondeductible contributions bears to the total current value of all IRAs of the individual.

Withdrawals from an IRA prior to age 59½, death, or disability are generally subject to an additional 10-percent income tax (sec. 72(t)). The 10-percent additional income tax is intended to recapture at least a portion of the tax benefit of the IRA. The 10-percent additional income tax does not apply to withdrawals that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of the taxpayer and the taxpayer's designated beneficiary. A similar early withdrawal tax applies to withdrawals from qualified retirement plans and deferred annuities.

Taxation of social security benefits

Under present law, individuals whose modified adjusted gross income is above certain levels must include in gross income a portion of social security benefits. The maximum proportion of benefits that must be included in gross income is one-half. Modified adjusted gross income equals adjusted gross income plus tax-exempt interest plus one-half of social security benefits. The threshold is $25,000 for single taxpayers and $32,000 for married taxpayers.

Explanation of Provisions

Individual retirement arrangements

IRA plus accounts

The proposal would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1994, and indexed for inflation beginning after 1996. In the case of married taxpayers, each spouse could contribute up to $2,000 if the combined compensation of the spouses is at least as great as the IRA plus contributions. Contributions could be made by an individual to an IRA plus account after the individual reaches age 70½.

Amounts held in present-law IRAs could be rolled over into an IRA plus account on or before the earlier of January 1, 1992, or the date the individual attains age 55. IRA contributions previously deducted would be included in income ratably over a 4-year period. Earnings on deductible contributions would not be taxed upon rollover; subsequent withdrawal of rolled-over amounts (and earnings thereon) would be taxed as described below.

Under the bill, income tax or the early withdrawal tax would not be imposed on withdrawals from IRA plus accounts if (1) the withdrawal is a qualified distribution, and (2) the withdrawal occurs at least 5 years after the individual first made a contribution (including a rollover contribution) to the IRA plus. A withdrawal would be a qualified distribution if it is (1) made on or after the individual attains age 59½, (2) made to a beneficiary after the individual's death, (3) attributable to the individual being disabled, or (4) within certain limits and made for a first-time home purchase or to pay ceratin educational or medical expenses.

Inflation adjustment of IRA contribution limit

The bill would increase the $2,000 IRA deduction limit for inflation beginning after 1996.

Taxation of social security benefits

The bill would adjust for inflation the income thresholds for taxation of social security benefits. Also, for the purpose of determining whether the thresholds are exceeded, withdrawals from IRAs would be excluded from income.

Effective Dates

Individual retirement arrangements

The provisions relating to IRA plus accounts would generally be effective for taxable years beginning after December 31, 1990.

Taxation of social security benefits

The provisions relating to the taxation of social security benefits would be effective beginning after 1996.

4. H.R. 2242, "Working Family Tax Relief Act of 1991" (Messrs. Downey, Miller of California, Obey, Stark, De Lugo, Donnelly, Rangel, Gibbons, Jacobs, Matsui, and others) [6]

a. Tax credit for dependent children

Present Law

Under present law, taxpayers are allowed a personal exemption for themselves (and their spouse, in the case of joint returns) and for each dependent. The exemption is structured as a deduction in determining taxable income. The level of the personal exemption was set at $2,000 for taxable years beginning in 1989 and has been indexed for inflation in subsequent years. For taxable years beginning in 1991, the personal exemption is $2,150.

Explanation of Provision

The bill would replace the present-law personal exemption deduction for children under age 18 with a refundable tax credit no larger than $800 per child. Each qualifying taxpayer would receive at least a credit of $400. The maximum credit would be equal to 20 percent of earned income of the taxpayer (and child support received), not to exceed $800 per child. The $800 and $400 amounts would be indexed for inflation beginning after December 31, 1993.

The refundable portion of the child credit would be payable in advance for certain taxpayers who elect such treatment. The Treasury Department would be directed to pay such taxpayers approximately 80 percent of the estimated refund in quarterly installments.

Effective Date

The provision would apply to taxable years beginning after December 31, 1992.

b. Personal exemption and itemized deduction phaseouts

Present Law

Under present law, the deduction for the personal exemptions is phased out for taxpayers with adjusted gross income ("AGI") above a threshold amount. For each $2,500 (or fraction thereof) of AGI above the threshold, the deduction for personal exemptions is reduced by two percent. For 1991, the threshold is $150,000 for married individuals filing joint returns, $125,000 for unmarried individuals filing as head of household, and $100,000 for unmarried individuals filing single returns. These threshold figures are to be adjusted for inflation for taxable years after 1991. This provision is effective for taxable years beginning after December 31, 1990, and before January 1, 1996.

Individuals are allowed deductions for certain personal (nonbusiness) expenses, such as State and local taxes, home mortgage inter-

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[6] Following introduction, H.R. 2242 was estimated to result in a revenue loss. In July 1991, Mr. Downey announced his intentions to modify the bill to eliminate the estimated revenue loss. The modified bill is described below.

est, certain medical expenses and casualty losses, and charitable contributions ("itemized deductions"). Under present law, the total of otherwise allowable itemized deductions that may be claimed by a taxpayer is reduced by an amount equal to three percent of the taxpayer's AGI in excess of $100,000. In no event may the reduction in itemized deductions exceed 80 percent of otherwise allowable deductions. The $100,000 threshold is adjusted for inflation for taxable years after 1991. This provision is effective for taxable years beginning after December 31, 1990, and before January 1, 1996.

Explanation of Provision

The present-law provisions under which personal exemptions and itemized deductions are phased out for higher income individuals would be repealed.

Effective Date

The provision would apply to taxable years beginning after December 31, 1991.

c. Earned income tax credit

Present Law

Eligible low-income workers may claim a refundable earned income tax credit ("EITC") of up to 16.7 percent (17.3 percent for taxpayers with more than one qualifying child) of the first $7,140 of earned income for 1991. The maximum amount of credit for 1991 is $1,192 ($1,235 for taxpayers with more than one qualifying child). This maximum is reduced by 11.93 percent (12.36 percent for taxpayers with more than 1 qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,250. The EITC is not available to workers with earned income (or adjusted gross income, if greater) over $21,245. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

[In percent]

Year	One qualifying child		Two or more qualifying children	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.4	13.14
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation.

As part of the EITC, a supplemental young child credit is available for qualifying children under the age of one year. This "young child credit" rate is 5 percent and the phase-out rate is 3.57 percent. In addition, a supplemental health insurance credit under the EITC is available to taxpayers who provide health insurance coverage for their qualifying children. The health insurance credit rate is 6 percent and the phase-out rate is 4.285 percent. Both supplemental credits are computed on the same base as the ordinary EITC.

Explanation of Provision

The supplemental young child component, the supplemental health insurance component, and the family-size adjustment component of the EITC would be repealed. The basic EITC credit rate would be increased as follows:

Year	EITC credit rate
1992	20
1993	22
1994 and thereafter	24

Effective Date

The provision would apply to taxable years beginning after December 31, 1991.

d. Individual income tax rates

Present Law

The 1991 individual income tax rates are shown in the following table:

If taxable income is	Then income tax equals
Single individuals	
\$0–\$20,350	15 percent of taxable income.
\$20,350–\$49,300	\$3,052.50 plus 28% of the amount over \$20,350.
Over \$49,300	\$11,158.50 plus 31% of the amount over \$49,300.
Heads of households	
\$0–\$27,300	15 percent of taxable income.
\$27,300–\$70,450	\$4,095 plus 28% of the amount over \$27,300.
Over \$70,450	\$16,177 plus 31% of the amount over \$70,450.

If taxable income is	Then income tax equals
Married individuals filing joint returns	
$0–$34,000	15 percent of taxable income.
$34,000–$82,150	$5,100 plus 28% of the amount over $34,000.
Over $82,150	$18,582 plus 31% of the amount over $82,150.

An individual taxpayer is subject to an alternative minimum tax ("AMT") if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent and is applied to the taxpayer's alternative minimum taxable income (generally computed by adding preference items to the taxpayer's regular taxable income).

Explanation of Provision

Increased individual income tax rates

The present-law regular tax 31-percent rate would be increased to 32 percent, and a new 36-percent rate would apply to taxable incomes in excess of—

Single individuals	$120,400
Heads of household	160,000
Married individuals filing joint returns and certain surviving spouses	200,000
Married individuals filing separate returns	100,000.

The individual alternative minimum tax rate would be increased to 29 percent.

Surtax

A 15-percent surtax would apply to tax attributable to AGI in excess of—

Single individuals	$150,000
Heads of household	200,000
Married individuals filing joint returns and certain surviving spouses	250,000
Married individuals filing separate returns	125,000.

Effective Dates

The provision would apply to taxable years beginning after December 31, 1991, except that the surtax would apply to taxable years beginning after December 31, 1992.

5. H.R. 3128, "All Americans Savings and Investment Incentive Act of 1991" (Messrs. Gallo, Michel, Lewis of California, Edwards of Oklahoma, Vander Jagt, Solomon, Walker, Cox of California, Hastert, and Armey, Ms. Molinari, Messrs. Hubbard, Weber, Saxton, Tauzin, Lewis of Florida, Shays, Kyl, Stump, Ravenel, Dornan of California, Combest, Roberts, Hammerschmidt, Baker, Hunter, Lent, Sensenbrenner, and Lagomarsino, Mrs. Vucanovich, Messrs. Spence, Ritter, Ballenger, Schaefer, Duncan, Emerson, Martin, Oxley, Kasich, Zimmer, Livingston, Burton, McEwen, Schiff, Rhodes, Gunderson, Slaughter of Virginia, Ramstad, Franks of Connecticut, Marlenee, Packard, Cunningham, Allard, Walsh, and Kolbe)

a. Capital gains exclusion for individuals

Present Law

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of certain depreciation, depletion, etc. recapture) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Explanation of Provision

The bill would allow individuals a partial exclusion of the gain realized upon the disposition of qualified capital assets. Assets held 3 years or more would qualify for a 30-percent exclusion; assets held at least 2 years but less than 3 years would qualify for a 20-percent exclusion; and assets held at least one year but less than 2 years would qualify for a 10-percent exclusion.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded.

The capital gains exclusion would be a preference for purposes of the alternative minimum tax.

Effective Date

The bill generally would apply to sales and exchanges after September 30, 1991.

b. Partial exclusion of interest

Present Law

Under present law, gross income includes interest and dividends received during the taxable year by an individual.

Explanation of Provision

The bill would exclude from gross income the first $350 of interest received ($700 in the case of a joint return). The amount of the exclusion available would be phased out for taxpayers with adjusted gross income (AGI) in the range of $50,000-$60,000 ($25,000-$35,000 for married, filing separately).

Nonresident aliens would be eligible for the exclusion only if the interest was earned in connection with a trade or business in the U.S. or if they are subject to the alternative tax for expatriates under Code section 877.

Interest on borrowing would not be excludable to the extent that the borrowed funds were used to obtain assets yielding excludible interest under this proposal. (Similar to the current rule regarding borrowing to obtain assets yielding tax-free interest.)

Some fraction of the dividends from real estate investment companies (RICs) and real estate investment trusts (REITs) may be treated as interest for the purposes of this proposed exclusion. In the case of a RIC, if the aggregate interest received by the RIC is at least 75 percent of the entity's gross income (calculated less deductions for interest paid and less gains from the sales of securities), then all of the dividend is treated as interest. If the percentage is less than 75, then only that percentage of the dividends is treated as interest.

In the case of a REIT, if the aggregate interest received by the REIT is at least 75 percent of the entity's gross income (calculated less deductions for interest paid (other than on mortgages on real property owned by the REIT) and less net capital gain), then all of the dividend is treated as interest. If the percentage is less than 75, then only that percentage of the dividends is treated as interest.

Effective Date

The provision would apply with respect to taxable years beginning after December 31, 1991.

6. H.R. 3130, "Economic Growth Act of 1991" (Messrs. Gingrich, Gunderson, Walker, McCollum, and Ireland, Mrs. Johnson, Messrs. Kyl, Hastert, McEwen, Kasich, Ramstad, Thomas of Wyoming, Rohrabacher, and Hunter)

a. Capital gains tax reduction and indexing

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of certain depreciation, depletion, etc. recapture) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Depreciation recapture

In general, gain on the sale or other disposition of section 1245 property (depreciable personal property) is taxed as ordinary income to the extent of all previous depreciation or amortization allowances with respect to the property. Gain on the sale or other disposition of section 1250 property (depreciable real property) is taxed as ordinary income to the extent of the excess of accelerated depreciation allowances over the depreciation allowances that would have been available under the straight-line method.

Indexing

The amount taken into account under present law in computing gain from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Explanation of Provisions

Capital gains

The bill would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held three years or more would qualify for a 30-percent exclusion; assets held at least two years but less than three years would qualify for a 20-percent exclusion; and assets held at least one year but less than two years would qualify for a 10-percent exclusion. For a taxpayer whose capital gains would otherwise be subject to a 28-percent rate, this would result in a regular tax rate of 19.6 percent for assets held three years or more, 22.4 percent for assets held between two and three years, and 25.2 percent for assets held between one and two years.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded.

The capital gains exclusion would be a preference for purposes of the alternative minimum tax. The amount treated as investment income for purposes of the investment interest limitation would be reduced by the capital gains exclusion attributable to investment assets.

Depreciation recapture

Under the bill, gain on the disposition of depreciable real property is taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

Indexing

In general

The bill generally provides individuals with an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain upon sale or other disposition. Assets eligible for the inflation adjustment generally include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment applies only to assets held more than one year. The deduction for depreciation, depletion and amortization is determined without regard to the inflation adjustment.

Indexed assets

The bill generally provides for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets are creditor's interests, options, net lease property, certain preferred stock, stock in S corporations, and certain foreign stock.[7]

[7] Stock in a foreign corporation that is listed on a domestic exchange generally is treated as an indexed asset.

Computation of inflation adjustment

The inflation adjustment under the bill is computed by dividing the consumer price index ("CPI") in the calendar year preceding the year the disposition occurs by the CPI in the calendar year preceding the year in which the asset was acquired by the taxpayer. The applicable inflation ratio is not taken into account unless it is greater than one. In addition, it is rounded to the nearest one-hundredth. The indexed basis is the adjusted basis of the asset, multiplied by the applicable inflation ratio.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset are not taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion is disregarded in determining the inflation ratio applicable to the disposition of the common stock. In addition, an asset is not treated as an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

The indexing adjustment generally does not apply to dispositions between related parties.

Special entities

In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs), partial indexing is provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio is generally determined every month. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock is allowed for that month. Where less than 10 percent of the assets are indexed assets in any month, no indexing is allowed that month for the stock.

In the case of partnerships, S corporations and common trust funds, inflation adjustments made at the entity level are passed through to the partners, shareholders and participants.

Effective Date

The capital gain provisions of the bill would apply to dispositions made on or after April 15, 1991. For the portion of 1991 to which the proposal would apply, a 30-percent exclusion would apply for all assets held one year or more. For 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years.

The indexing provisions of the bill generally would apply to dispositions of any property the holding period of which begins after April 15, 1991.

b. Enterprise zones

Present Law

Targeted geographic areas

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, the provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas. Similarly, for purposes of the low-income housing credit, certain geographic areas are designated as high cost or difficult to develop areas for the purpose of increasing the rate of credit applicable to such areas. In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States as a means to encourage the conduct of trades or businesses within these areas.

Tax credits for employees

Under present law, the income tax liability of an employee does not vary based on where the employee performs services in the United States on behalf of an employer. However, an eligible individual who maintains a home for one or more qualifying children is allowed an advance refundable income tax credit based on the earned income of the individual and the number of qualifying children.

The targeted jobs tax credit under present law provides an income tax credit to employers for a portion of the wages paid to certain employees, who generally are either economically disadvantaged or participating in a specific education or rehabilitation program.

Capital gains

Net capital gains are taxed as ordinary income under present law, subject to a maximum marginal rate of 28 percent in the case of individuals. Before 1987, net capital gains were taxed at a reduced rate. All taxpayers other than corporations could reduce net capital gains by 60 percent, and the remainder was taxed as ordinary income—effectively establishing a maximum 20-percent tax rate. The maximum tax rate for net capital gains of corporations was 28 percent. This reduction in tax for capital gains was treated as a preference item for purposes of computing the minimum tax.

Expensing of certain investments

There is no provision under present law that allows the amount of an investment to be expensed (i.e., deducted for the year in which the investment occurs) based on the location of the investment. Present law, however, provides that in lieu of a depreciation deduction, a taxpayer (other than an estate or trust) may elect to deduct all or a portion of the cost of qualifying property for the taxable year in which the property is placed in service. The maximum amount that may be expensed under this provision for any taxable year is $10,000. In general, qualifying property is any tangible personal property that is predominantly used in the active conduct of a trade or business.

Nontax provisions

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on goods imported into a foreign trade zone until the time that the goods leave the foreign trade zone for shipment to other areas of the United States.

Regulatory flexibility

Under present law, government agencies must follow certain procedures in promulgating regulations that are designed to ease the regulatory burden on small businesses, small nonprofit organizations, and small governmental jurisdictions.

Housing and Community Development Act of 1987

Under Title VII of the Housing and Community Development Act of 1987, the Secretary of Housing and Urban Development (HUD) may designate not more than 100 nominated areas as enterprise zones (42 U.S.C. sec. 11501 et seq.).[8] An area may be so designated after being nominated by one or more local governments and the State in which it is located. An area may be designated as an enterprise zone only if it meets certain requirements concerning area boundaries, population, unemployment, poverty, and other signs of economic distress. At least one-third of the designated enterprise zones must be within rural areas.

No area may be designated as an enterprise zone unless the local government and the State (or, in the case of a nominated area on an Indian reservation, the reservation governing body) in which the area is located provide commitments that such governments will follow a specified course of action designed to reduce various burdens borne by employers or employees in the nominated area. An enterprise zone designation generally is to remain in effect for 24 years.

Explanation of Provisions

Designation of enterprise zones

H.R. 3744 would authorize the Secretary of HUD to designate up to 50 enterprise zones from areas nominated by State and local governments (or an Indian reservation governing body). The designations would be made over a four-year period, with not more than 15 designations being made during each of the first three years. At least one-third of the designated zones would be required to be in rural areas (generally defined as an area within a jurisdiction with a population of less than 50,000 or outside a metropolitan statistical area). The designation of an area as an enterprise zone generally would be effective for 25 years.

Designated enterprise zones would be required to meet certain requirements concerning area boundaries, population, unemployment, poverty, and other signs of economic distress. In addition, the local government and State in which the zones are located

[8] Prior to January 1, 1989, HUD received 270 nominations of areas seeking to be designated as enterprise zones. Thus far, no area has been designated as an enterprise zone.

would be required to agree to follow a specified course of action designed to benefit employers and employees in the zones.

The Secretary of HUD would be required to designate enterprise zones from eligible areas on the basis of the following selection criteria: (1) the strength and quality of promised contributions by State and local governments relative to their fiscal ability; (2) the effectiveness and enforceability of the proposed courses of action by the State and local governments; (3) the level of commitments by private entities; (4) other factors, including relative distress; and (5) reasonable geographic distribution of enterprise zones.

Employment tax credit

The bill would provide a 5-percent refundable tax credit to certain enterprise zone employees for the first $10,500 of wages. The maximum credit would be $525; it would be phased out between $20,000 and $25,000 of total wages. The credit would be reduced for individuals subject to the alternative minimum tax.

To qualify for the credit, the employee would be required to perform substantially all of his or her services within an enterprise zone for an enterprise zone business, generally meaning a business with 80 percent of its gross income attributable to active business activities conducted within the zone.

Exclusion of enterprise zone capital gain

The bill would exclude from income certain long-term capital gain realized from the disposition of enterprise zone property, generally defined as real property and tangible personal property (other than financial property and collectibles) located in an enterprise zone and used in an enterprise zone business. The property must have constituted enterprise zone property for at least two years prior to disposition. The gain exclusion would not be a preference item for purposes of the alternative minimum tax.

Deduction for purchases of enterprise zone stock

Under the bill, individuals could elect to deduct up to $50,000 per year of the purchase price of enterprise zone stock, subject to a $250,000 lifetime limitation. Any gain on the sale of the stock would be recaptured as ordinary income. In addition, the tax benefit of the deduction would be reduced if the stock were held less than five years when sold. The deduction would be treated as a preference item for purposes of computing an individual's alternative minimum tax.

In order for stock to qualify as enterprise zone stock, the following requirements would have to be met: (1) the stock must be common stock; (2) the amount of the proceeds must be used by the issuer within 12 months to acquire enterprise zone property; and (3) the issuer must be a subchapter C corporation (a) which does not have more than one class of stock, (b) which is engaged solely in the conduct of an enterprise zone business, (c) which does not own or lease more than $5 million of property, and (d) more than 20 percent of whose stock is owned by individuals, partnerships, estates or trusts. In addition, a corporation could not issue more than $5 million of enterprise zone stock.

Nontax provisions

Foreign trade zones

The bill would require the Foreign Trade Zone Board to consider on a priority basis the processing of any applications that involve the establishment of a foreign-trade zone in an enterprise zone.

Regulatory flexibility

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified enterprise zone business, and certain other enterprises. The bill would also provide for waiver or modification of Federal agency rules to foster economic development activities in enterprise zones.

Repeal of Title VII of 1987 Housing Act

The bill would repeal Title VII of the Housing and Community Development Act of 1987.

Effective Date

The tax provisions would be effective for taxable years ending after December 31, 1990. The nontax provisions generally would be effective upon enactment.

c. Permanent extension of research credit

Present Law

General rule

A 20-percent tax credit is allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit will not apply to amounts paid or incurred after December 31, 1991.[9]

A 20-percent tax credit also applies to the *excess* of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research *over* (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

Computation of allowable credit

Except for certain university basic research payments, the credit applies only to the extent that the taxpayer's qualified research expenditures for the taxable year exceed its base amount. The base amount for the current year is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years.

If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 to 1988, then its "fixed-base percentage" is the ratio that its total qualified

[9] H.R. 3909, which was passed by the House of Representatives and Senate on November 27, 1991, would extend the research credit for six months (i.e., for qualified expenditures paid or incurred through June 30, 1992).

research expenses for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (such as "start-up" firms) are assigned a fixed-base percentage of .03.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

Relation to deduction

Deductions for qualified research expenditures allowed to a taxpayer under section 174 or any other provision are reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

Explanation of Provision

The bill would permanently extend the tax credit for qualified research expenditures (including university basic research payments).

Effective Date

The provision would be effective for taxable years beginning after December 31, 1990.

d. Individual retirement arrangements (IRAs)

Present Law

In general

Under certain circumstances, an individual is allowed a deduction for contributions (within limits) to an individual retirement account or an individual retirement annuity (an IRA) (Code sec. 219). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA.

Under present law, the maximum deductible contribution that can be made to an IRA generally is the lesser of $ 2,000 or 100 percent of an individual's compensation (earned income in the case of self-employed individuals). In addition, a married taxpayer who files a joint return with his or her spouse can make an additional contribution of up to $250 to an IRA established for the benefit of the spouse, if the spouse has no compensation or elects to be treated as having no compensation. A single taxpayer is permitted to make the maximum deductible IRA contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has adjusted gross income (AGI) of less than $25,000. A married taxpayer filing a joint return is permitted to make the maximum deductible IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married couple) is an active participant in an employer-sponsored retirement plan, the maximum IRA deduction is phased out over certain

AGI levels. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Nondeductible IRA contributions

Individuals may make nondeductible IRA contributions to the extent deductible contributions are not allowed because of the AGI phaseout and active participant rules. A taxpayer may also elect to make nondeductible contributions in lieu of deductible contributions. Thus, any individual may make nondeductible contributions up to the excess of (1) the lesser of $2,000 or 100 percent of compensation over (2) the IRA deduction claimed by the individual. An individual making nondeductible contributions is required to report the amount of such contributions on his or her tax return. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions are not subject to income tax until withdrawn.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than amounts that represent a return of nondeductible contributions) are includible in income when withdrawn. If an individual withdraws an amount from an IRA during a taxable year and the individual has previously made both deductible and nondeductible IRA contributions, then the amount includible in income for the taxable year is the excess of the amount withdrawn over the portion of the amount withdrawn attributable to investment in the contract (i.e., nondeductible contributions). The amount attributable to nondeductible contributions is the portion of the amount withdrawn that bears the same ratio to the amount withdrawn as the total amount of nondeductible contributions bears to the total current value of all IRAs of the individual.

Withdrawals from an IRA prior to age 59½, death, or disability are generally subject to an additional 10-percent income tax (sec. 72(t)). The 10-percent additional income tax is intended to recapture at least a portion of the tax benefit of the IRA. The 10-percent additional income tax does not apply to withdrawals that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of the taxpayer and the taxpayer's designated beneficiary. A similar early withdrawal tax applies to withdrawals from qualified retirement plans and deferred annuities.

Explanation of Provisions

IRA plus accounts

The bill would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996. In the case of married taxpayers, each spouse could contribute up to $2,000 if the combined compensation of the spouses was at least as great as the IRA plus contributions. Contributions could be made by an individual to an IRA plus account after the individual reaches age 70½.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59½ or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from normal IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. Balances originating from qualified retirement plans other than IRAs could not be rolled over into an IRA plus account. In the case of a rollover from a normal IRA made on or before the earlier of (1) the date on which the individual attains age 55, or (2) June 30, 1993, the tax on the includible amount of the rollover would be spread ratably over the 4 taxable year period beginning with the taxable year in which the amount was paid out of the IRA. Amounts that are rolled over could not be distributed tax-free until 5 years after the date of the rollover.

Penalty-free IRA withdrawals for qualified expenses

The bill would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home, certain education expenses, and certain medical expenses. Amounts in excess of the 25 percent limit would be subject to income tax, but would not be subject to the additional 10-percent tax on early withdrawals. Individuals also could withdraw funds to help children and grandchildren with a qualified expense.

The basis of a home purchased with the proceeds of a tax-free IRA distribution would be reduced by the amount excluded from income. Upon sale of the home, gain up to the amount of the excludable distribution would be treated as ordinary income and the 10-percent tax on early withdrawals would apply except to the extent such gain is rolled over into an IRA.

Effective Date

The provision would apply to taxable years beginning after December 31, 1991.

e. Increase social security earnings limitation

Present Law

Social security benefits are reduced for certain beneficiaries if they have wages or earned income in excess of a certain amount. For 1991, the exempt amount in the case of beneficiaries under age 65 is $7,080. For such beneficiaries, benefits are reduced by $1 for each $2 of wages or earnings in excess of the exempt amount. For 1991, the exempt amount in the case of beneficiaries age 65–69 is $9,720, and benefits are reduced for such beneficiaries by $1 for each $3 of wages or earnings in excess of the exempt amount. The reduction does not apply to beneficiaries age 70 or older. The exempt amounts are adjusted each year for inflation.

Explanation of Provision

The bill would increase the exempt amount $1,000 per year over a period of 5 years, beginning after 1991. The bill also would appropriate funds to pay for the increases in benefits under the bill. Sufficient funds to pay the increase in benefits are to be transferred at least quarterly from the general funds of the Treasury to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The Secretary of the Treasury is to report annually to the Congress and the Secretary of Health and Human Services on the transfers made during the year and the anticipated operation of the bill during the next 5 years.

Effective Date

The provision would apply to taxable years ending after 1991.

f. First-time homebuyers' tax credit

Present Law

There is no credit for first-time homebuyers under present law.

Explanation of Provision

The bill would give first-time homebuyers a refundable tax credit of $1000 for the purchase of a principal residence. The amount of the credit would be phased out for taxpayers with adjusted gross income ("AGI") between $31,000 and $41,000. In the case of married people, regardless of filing status, both spouses' AGIs would be combined for purposes of the phaseout. If two or more people purchase the house for use as their principal residence, then the $1,000 credit would be split among them (according to regulations) as long as all of the purchasers are first-time homebuyers and as long as their combined AGIs were used for purposes of the phaseout.

First-time homebuyers are defined as individuals who had no present ownership interest in a principal residence during the 3-year period prior to the acquisition of the property qualifying for the credit. If the individual is married, his or her spouse must also meet the above test in order for the individual to be characterized as a "first-time homebuyer."

Properties for which the purchaser's basis is determined by reference to the adjusted basis of the seller or by application of Code sec. 1014(a) (relating to property acquired from a decedent) would not be eligible for the credit. The size of the credit and the phaseout range would not be indexed for inflation.

Effective Date

The bill would apply to purchases of principal residences after July 31, 1991.

g. Growth dividend/personal exemption

Present Law

Taxpayers are allowed a personal exemption for themselves (and spouse, in the case of a joint return) and for each dependent of the taxpayer. The exemption is structured as a deduction in determining taxable income. The amount of the personal exemption was set at $2,000 for taxable years beginning in 1989 and is indexed for inflation in subsequent years. For taxable years beginning in 1991, the personal exemption is $2,150.

Explanation of Provision

The bill would increase the amount of the personal exemption for taxable years beginning after the Secretary of the Treasury (the Secretary) declared an "economic growth dividend" for any fiscal year after fiscal year 1991. The amount of the personal exemption would continue to be indexed for inflation.

In fiscal years 1992–1995, an economic growth dividend would be declared by the Secretary if he determined that the real growth of the gross national product (GNP) exceeded the estimate of the GNP included in the President's budget for that fiscal year. The Secretary would determine the increase in Federal tax receipts due to this excess growth and apply one-half of the increased receipts to an increase in the amount of the personal exemption and one-half to deficit reduction.

In fiscal years 1996 and thereafter, an economic growth dividend would be declared by the Secretary if he determined that the real growth in the GNP exceeded 3 percent. All the increased receipts would be applied to increase the amount of the personal exemption.

7. "Family and Corporate Tax Sense Act of 1992" (Mr. Schulze), including H.R. 3170, "The Uniform Business Tax Act of 1991" (Messrs. Schulze, Guarini, Thomas, Applegate, Bustamante, Cunningham, DeFazio, Duncan, Fish, Gekas, Horton, Huckaby, Hunter, Lent, Lipinski, Moran, Ravenel, Regula, Rowland, Skeen, and Walsh, and Mrs. Bentley and Ms. Kaptur)

a. Uniform business tax (H.R. 3170)

Present Law

A corporation is subject to tax, generally at a 34-percent rate, on its taxable income. In addition, if the alternative minimum tax of a corporation exceeds its regular tax liability, the corporation is subject to the alternative minimum tax. The corporate alternative minimum tax is an income tax imposed at a 20-percent rate on a base that is generally broader than the taxable income of the regular tax.

Social security benefits are financed primarily by payroll taxes on covered wages. Thus, in addition to other taxes, an employer is subject to an old age, survivors, and disability insurance excise tax equal to 6.2 percent of the covered wages (up to $53,400) paid to each of its employees. In addition, an employer is subject to a hospital insurance excise tax equal to 1.45 percent of the covered wages (up to $125,000) paid to each of its employees.

Explanation of Provisions

In general

Under the bill (H.R. 3170), a uniform business tax (UBT) would be imposed equal to 9 percent of the taxable value of goods and services produced and sold in the United States by a taxable business. The UBT would replace the corporate income tax and the corporate alternative minimum tax, which would be repealed. In addition, the UBT would be creditable against the payroll tax liability of an employer. To the extent a corporation's payroll tax liability exceeds its UBT liability, such excess could be carried forward and credited against its future UBT liability. For a noncorporate taxpayer, the portion of the UBT in excess of the payroll tax liability could be credited against the taxpayer's income tax.

The UBT also would be imposed on the customs value of imported property, with a de minimis exception for certain personal use items.

Taxable businesses

The UBT would apply to all subchapter C corporations and any other taxpayer that has business receipts in excess of $50,000 for the taxable year. All persons under common control would be treated as one person for purposes of the $50,000 threshold. The UBT liability of a partnership or subchapter S corporation would be determined at the entity level. The UBT would not be imposed on organizations exempt from the income tax under present law.

Tax base

The tax base of the UBT is the amount of business receipts in excess of business expenses of the taxpayer for the taxable year.

Business receipts include receipts from the sale or rental of property, sale or use of intangibles, and the performance of services in the United States. The amount of business receipts is reduced by the amount of any returns or allowances for the year. Business receipts exclude receipts from the sale or resale of property for export; the collection of separately-stated State and local sales taxes; dividends received; interest received; and the sale of any financial asset, land, or any property not used in the taxpayer's trade or business.

Business expenses include amounts paid by the taxpayer for the purchase or use of property (including capital goods) or the purchase of services and certain products taxes. As a transitional rule, business expenses generally include the depreciation, depletion, or amortization of the remaining adjusted basis of assets subject to depreciation, depletion, or amortization under present law. Under the UBT, such assets would be recovered over 30 or 10 years, depending on whether the remaining recovery period is more or less than 15 years under present law. As additional transitional rule, unused net operating losses and of unused tax credits may be carried forward and used to offset the UBT.

Business expenses exclude interest paid; dividends paid; amounts paid for land, financial instruments, and capital assets not used in the taxpayer's trade or business; amounts paid to certain exempt entities; wages and salaries; amounts paid for employee benefits, including pension, health, dependent care, group legal, and educational benefits and amounts paid for property for use or consumption outside the United States. In addition, business expenses exclude amounts paid for services performed outside of the United States, for the use of intangibles outside of the United States, or for property located outside of the United States for consumption, use, or disposition outside of the United States.

Special rules

The purchase or sale of property is treated as occurring where delivery takes place. The purchase or sale of real property is treated as occurring where the real property is located.

In the case of services provided by the taxpayer both inside and outside the United States, the services generally are treated as provided inside the United States. In the case of services received by the taxpayer both inside and outside the United States, the services generally are treated as received outside the United States. These rebuttable presumptions may be overcome by a showing of an invoice, contract or other agreement to the contrary.

In the case of insurance activities, lending activities, or other similar activities involving intermediation, the net business receipts from such activities are the amount attributable to the intermediation services provided less attributable business expenses.

A possessions corporation may elect to include 50 percent of "possessions" or "covered" sales a business receipts and not treat any expenses as business expenses.

Creditability and deductibility of UBT

The minimum tax portion of the UBT (i.e., the amount equal to the employer payroll tax liability) would be deductible. The excess portion (i.e., total UBT liability less the minimum tax portion), would be creditable against individual income tax in the case of tax paid by unincorporated businesses and against future UBT liability in the case of corporations.

Taxable year, tax return, estimated tax payments

The taxable year of a person subject to the UBT would be the person's taxable year or the calendar year. Each UBT taxpayer would file a UBT return no later than the time for filing that person's income tax return. Corporate estimated tax payments would be required for the portion of the UBT that exceeds the minimum tax portion.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1990.

b. Capital gains; depreciation recapture

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of certain depreciation, depletion, etc. recapture) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Depreciation recapture

In general, gain on the sale or other disposition of section 1245 property (depreciable personal property) is taxed as ordinary income to the extent of all previous depreciation or amortization allowances with respect to the property. Gain on the sale or other disposition of section 1250 property (depreciable real property) is taxed as ordinary income to the extent of the excess of accelerated depreciation allowances over the depreciation allowances that would have been available under the straight-line method.

Explanation of Provisions

Capital gains

The bill would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held three years or more would qualify for a 30-percent exclusion; assets held at least two years but less than three years would qualify for a 20-percent exclusion; and assets held at least one year but less than two years would qualify for a 10-percent exclusion. For a taxpayer whose capital gains would otherwise be subject to a 28-percent rate, this would result in a regular tax rate of 19.6 percent for assets held three years or more, 22.4 percent for assets held between two and three years, and 25.2 percent for assets held between one and two years.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded.

The capital gains exclusion would be a preference for purposes of the alternative minimum tax. The amount treated as investment income for purposes of the investment interest limitation would be reduced by the capital gains exclusion attributable to investment assets.

Depreciation recapture

Under the bill, gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

Effective Date

The bill would apply to dispositions (and installment payments received) after date of enactment. For the portion of 1991 to which the proposal would apply, a 30-percent exclusion would apply for all assets held one year or more. For 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years.

c. Social security payroll taxes

Present Law

Social security benefits are financed by payroll taxes on covered wages and income taxes imposed on social security benefits of higher-income taxpayers. In 1991, employers and employees each pay an old-age, survivor, and disability income (OASDI) tax equal to 6.2 percent of the first $53,400 of covered wages. Similarly, self-employed persons pay a tax on self-employment income up to $53,400 at the combined employer-employee rate of 12.4 percent. A hospital insurance tax (HI) is imposed on employers and employees equal to 1.45 percent (2.9 percent in the case of self-employed persons) of wages up to $125,000. Self-employed individuals are permitted to deduct one-half of their self-employment taxes in determining income tax liability.

Explanation of Provision

The proposal would lower the social security payroll tax rates by 1 percentage point.

Effective Date

The proposal would be effective beginning in 1993.

d. Exclusion of gain on the sale of a principal residence (H.R. 1287—Messrs. Schulze, Thomas of California, Bunning, and others)

Present Law

In general, a taxpayer may elect to exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale, and (2) has used the residence as a principal residence for three or more years of the five years preceding sale of the residence (sec. 121). The election may be made only once.

Explanation of Provision

H.R. 1287 would repeal the age and dollar limitations on the exclusion of gain on the sale of a principal residence.

Effective Date

The provision would apply to sales and exchanges after the date of enactment.

e. Personal exemption

Present Law

Under present law, taxpayers are allowed a personal exemption for themselves (and spouse, in the case of a joint return) and for each dependent of the taxpayer. The exemption is structured as a deduction in determining taxable income. The level of the personal exemption was set at $2,000 for taxable years beginning in 1989 and has been indexed for inflation in subsequent years. For taxable years beginning in 1991, the personal exemption is $2,150.

Explanation of Provision

The proposal would increase the personal exemption for dependent children under age 18 to $3,500.

Effective Date

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

8. H.R. 3678, "Economic Growth Act of 1991" (Mr. Walker)

a. Capital gains tax reduction and indexing

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of certain depreciation, depletion, etc. recapture) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Depreciation recapture

In general, gain on the sale or other disposition of section 1245 property (depreciable personal property) is taxed as ordinary income to the extent of all previous depreciation or amortization allowances with respect to the property. Gain on the sale or other disposition of section 1250 property (depreciable real property) is taxed as ordinary income to the extent of the excess of accelerated depreciation allowances over the depreciation allowances that would have been available under the straight-line method.

Indexing

The amount taken into account under present law in computing gain from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Explanation of Provisions

Capital gains

Under the bill, an individual would be allowed a deduction equal to 33 percent of his net capital gain for the taxable year. Net capital gain from the sale or exchange of capital assets as defined under present law generally would be eligible for the deduction, except that any gain or loss from the sale or exchange of a collectible would be treated as a short-term capital gain or loss.

The capital gain deduction would not apply for purposes of computing alternative minimum taxable income.

Depreciation recapture

Under the bill, gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

Indexing

In general

The bill generally would provide individuals with an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

Indexed assets

The bill generally would provide for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations, and certain foreign stock.[10]

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by dividing the consumer price index ("CPI") in the calendar year preceding the year the disposition occurs by the CPI in the calendar year preceding the year in which the asset was acquired by the taxpayer. The applicable inflation ratio would not be taken into account unless it is greater than one. In addition, it would be rounded to the nearest one-hundredth. The indexed basis would be the adjusted basis of the asset, multiplied by the applicable inflation ratio.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset would not be taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion would be disregarded in determining the inflation ratio applicable to the disposition of the common stock. In addition, an asset would not be treated as an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

The indexing adjustment generally would not apply to dispositions between related parties.

Special entities

In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs), partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio generally would be determined every month. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock would be allowed for that month. Where less

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[10] Stock in a foreign corporation that is listed on a domestic exchange generally would be treated as an indexed asset.

than 10 percent of the assets are indexed assets in any month, no indexing would be allowed that month for the stock.

In the case of partnerships, S corporations and common trust funds, inflation adjustments made at the entity level would be passed through to the partners, shareholders and participants.

Effective Dates

The capital gain provisions of the bill would apply to taxable years beginning after the date of enactment. The depreciation recapture provisions would apply to dispositions made after the date of enactment. The indexing provisions generally would apply to dispositions of any property the holding period of which begins after the date of enactment.

b. Enterprise zones

Present Law

Targeted geographic areas

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, the provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas. Similarly, for purposes of the low-income housing credit, certain geographic areas are designated as high cost or difficult to develop areas for the purpose of increasing the rate of credit applicable to such areas. In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States as a means to encourage the conduct of trades or businesses within these areas.

Tax credits for employees

Under present law, the income tax liability of an employee does not vary based on where the employee performs services in the United States on behalf of an employer. However, an eligible individual who maintains a home for one or more qualifying children is allowed an advance refundable income tax credit based on the earned income of the individual and the number of qualifying children.

The targeted jobs tax credit under present law provides an income tax credit to employers for a portion of the wages paid to certain employees, who generally are either economically disadvantaged or participating in a specific education or rehabilitation program.

Capital gains

Net capital gains are taxed as ordinary income under present law, subject to a maximum marginal rate of 28 percent in the case of individuals. Before 1987, net capital gains were taxed at a reduced rate. All taxpayers other than corporations could reduce net capital gains by 60 percent, and the remainder was taxed as ordinary income—effectively establishing a maximum 20-percent tax rate. The maximum tax rate for net capital gains of corporations was 28 percent. This reduction in tax for capital gains was treated as a preference item for purposes of computing the minimum tax.

Expensing of certain investments

There is no provision under present law that allows the amount of an investment to be expensed (i.e., deducted for the year in which the investment occurs) based on the location of the investment. Present law, however, provides that in lieu of a depreciation deduction, a taxpayer (other than an estate or trust) may elect to deduct all or a portion of the cost of qualifying property for the taxable year in which the property is placed in service. The maximum amount that may be expensed under this provision for any taxable year is $10,000. In general, qualifying property is any tangible personal property that is predominantly used in the active conduct of a trade or business.

Nontax provisions

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on goods imported into a foreign trade zone until the time that the goods leave the foreign trade zone for shipment to other areas of the United States.

Regulatory flexibility

Under present law, government agencies must follow certain procedures in promulgating regulations that are designed to ease the regulatory burden on small businesses, small nonprofit organizations, and small governmental jurisdictions.

Housing and Community Development Act of 1987

Under Title VII of the Housing and Community Development Act of 1987, the Secretary of Housing and Urban Development (HUD) may designate not more than 100 nominated areas as enterprise zones (42 U.S.C. sec. 11501 et seq.).[11] An area may be so designated after being nominated by one or more local governments and the State in which it is located. An area may be designated as an enterprise zone only if it meets certain requirements concerning area boundaries, population, unemployment, poverty, and other signs of economic distress. At least one-third of the designated enterprise zones must be within rural areas.

No area may be designated as an enterprise zone unless the local government and the State (or, in the case of a nominated area on an Indian reservation, the reservation governing body) in which the area is located provide commitments that such governments will follow a specified course of action designed to reduce various burdens borne by employers or employees in the nominated area. An enterprise zone designation generally is to remain in effect for 24 years.

[11] Prior to January 1, 1989, HUD received 270 nominations of areas seeking to be designated as enterprise zones. Thus far, no area has been designated as an enterprise zone.

Explanation of Provisions

Designation of enterprise zones

H.R. 3678 would authorize the Secretary of HUD to designate up to 50 enterprise zones from areas nominated by State and local governments (or an Indian reservation governing body). The designations would be made over a four-year period, with not more than 15 designations being made during each of the first three years. At least one-third of the designated zones would be required to be in rural areas (generally meaning within a jurisdiction with a population of less than 50,000 or outside a metropolitan statistical area). The designation of an area as an enterprise zone generally would be effective for 25 years.

Designated enterprise zones would be required to meet certain requirements concerning area boundaries, population, unemployment, poverty, and other signs of economic distress. In addition, the local government and State in which the zones are located would be required to agree to follow a specified course of action designed to benefit employers and employees in the zones.

The Secretary of HUD would be required to designate enterprise zones from eligible areas on the basis of the following selection criteria: (1) the strength and quality of promised contributions by State and local governments relative to their fiscal ability; (2) the effectiveness and enforceability of the proposed courses of action by the State and local governments; (3) the level of commitments by private entities; (4) other factors, including relative distress; and (5) reasonable geographic distribution of enterprise zones.

Employment tax credit

The bill would provide a 5-percent refundable tax credit to certain enterprise zone employees for the first $10,500 of wages. The maximum credit would be $525; it would be phased out between $20,000 and $25,000 of total wages. The credit would be reduced for individuals subject to the alternative minimum tax.

To qualify for the credit, the employee would be required to perform substantially all of his or her services within an enterprise zone for an enterprise zone business, generally meaning a business with 80 percent of its gross income attributable to active business activities conducted within the zone.

Exclusion of enterprise zone capital gain

The bill would exclude from income certain long-term capital gain realized from the disposition of enterprise zone property, generally defined as real property and tangible personal property (other than financial property and collectibles) located in an enterprise zone and used in an enterprise zone business. The property must have constituted enterprise zone property for at least two years prior to disposition. The gain exclusion would not be a preference item for purposes of the alternative minimum tax.

Deduction for purchases of enterprise zone stock

Under the bill, individuals could elect to deduct up to $50,000 per year of the purchase price of enterprise zone stock, subject to a $250,000 lifetime limitation. Any gain on the sale of the stock would be recaptured as ordinary income. In addition, the tax benefit of the deduction would be reduced if the stock were held less than five years when sold. The deduction would be treated as a preference item for purposes of computing an individual's alternative minimum tax.

In order for stock to qualify as enterprise zone stock, the following requirements would have to be met: (1) the stock must be common stock; (2) the amount of the proceeds must be used by the issuer within 12 months to acquire enterprise zone property; and (3) the issuer must be a subchapter C corporation (a) which does not have more than one class of stock, (b) which is engaged solely in the conduct of an enterprise zone business, (c) which does not own or lease more than $5 million of property, and (d) more than 20 percent of whose stock is owned by individuals, partnerships, estates or trusts. In addition, a corporation could not issue more than $5 million of enterprise zone stock.

Nontax provisions

Foreign trade zones

The bill would require the Foreign Trade Zone Board to consider on a priority basis the processing of any applications that involve the establishment of a foreign-trade zone in an enterprise zone.

Regulatory flexibility

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified enterprise zone business, and certain other enterprises. The bill would also provide for waiver or modification of Federal agency rules to foster economic development activities in enterprise zones.

Repeal of Title VII of 1987 Housing Act

The bill would repeal Title VII of the Housing and Community Development Act of 1987.

Effective Date

The tax provisions would be effective for taxable years ending after the date of enactment of the bill. The nontax provisions generally would be effective upon enactment.

c. Permanent extension of research credit

Present Law

General rule

A 20-percent tax credit is allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit will not apply to amounts paid or incurred after December 31, 1991.[12]

[12] H.R. 3909, which was passed by the House of Representatives and Senate on November 27, 1991, would extend the research credit for six months (i.e., for qualified expenditures paid or incurred through June 30, 1992).

A 20-percent tax credit also applies to the *excess* of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research *over* (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

Computation of allowable credit

Except for certain university basic research payments, the credit applies only to the extent that the taxpayer's qualified research expenditures for the taxable year exceed its base amount. The base amount for the current year is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years.

If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 to 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenses for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (such as "start-up" firms) are assigned a fixed-base percentage of .03.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

Relation to deduction

Deductions for qualified research expenditures allowed to a taxpayer under section 174 or any other provision are reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

Explanation of Provision

The bill would permanently extend the tax credit for qualified research expenditures (including university basic research payments).

Effective Date

The provision would be effective for taxable years beginning after December 31, 1990.

d. Individual retirement arrangements (IRAs)

Present Law

In general

Under certain circumstances, an individual is allowed a deduction for contributions (within limits) to an individual retirement account or an individual retirement annuity (an IRA) (Code sec. 219). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA.

Under present law, the maximum deductible contribution that can be made to an IRA generally is the lesser of $ 2,000 or 100 percent of an individual's compensation (earned income in the case of self-employed individuals). In addition, a married taxpayer who files a joint return with his or her spouse can make an additional contribution of up to $250 to an IRA established for the benefit of the spouse, if the spouse has no compensation or elects to be treated as having no compensation. A single taxpayer is permitted to make the maximum deductible IRA contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has adjusted gross income (AGI) of less than $25,000. A married taxpayer filing a joint return is permitted to make the maximum deductible IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married couple) is an active participant in an employer-sponsored retirement plan, the maximum IRA deduction is phased out over certain AGI levels. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Nondeductible IRA contributions

Individuals may make nondeductible IRA contributions to the extent deductible contributions are not allowed because of the AGI phaseout and active participant rules. A taxpayer may also elect to make nondeductible contributions in lieu of deductible contributions. Thus, any individual may make nondeductible contributions up to the excess of (1) the lesser of $2,000 or 100 percent of compensation over (2) the IRA deduction claimed by the individual. An individual making nondeductible contributions is required to report the amount of such contributions on his or her tax return. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions are not subject to income tax until withdrawn.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than amounts that represent a return of nondeductible contributions) are includible in income when withdrawn. If an individual withdraws an amount from an IRA during a taxable year and the individual has previously made both deductible and nondeductible IRA contributions, then the amount includible in income for the taxable year is the excess of the amount withdrawn over the portion of the amount withdrawn attributable to investment in the contract (i.e., nondeductible contributions). The amount attributable to nondeductible contributions is the portion of the amount withdrawn that bears the same ratio to the amount withdrawn as the total amount of nondeductible contributions bears to the total current value of all IRAs of the individual.

Withdrawals from an IRA prior to age 59½, death, or disability are generally subject to an additional 10-percent income tax (sec. 72(t)). The 10-percent additional income tax is intended to recapture at least a portion of the tax benefit of the IRA. The 10-percent additional income tax does not apply to withdrawals that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of the taxpayer and the taxpayer's designated beneficiary. A similar early withdrawal tax applies to withdrawals from qualified retirement plans and deferred annuities.

Explanation of Provisions

IRA plus accounts

The provision would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996. In the case of married taxpayers, each spouse could contribute up to $2,000 if the combined compensation of the spouses was at least as great as the IRA plus contributions. Contributions could be made by an individual to an IRA plus account after the individual reaches age 70½.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59½ or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. The tax on the includible amount of the rollover would be spread ratably over the 4-taxable year period beginning with the taxable year in which the amount was paid out of the IRA. Balances originating from qualified retirement plans other than IRAs could not be rolled over into an IRA plus account. In order to receive this tax treatment, the rollover from an IRA must occur on or before the earlier of (1) the date on which the individual attains age 55, or (2) June 30, 1993. Amounts that are rolled over could not be distributed tax-free until 5 years after the date of the rollover.

The provision would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA plus account for the purchase of a first home, certain education expenses, and certain medical expenses. Amounts in excess of the 25-percent limit would be subject to income tax, but would not be subject to the additional 10-percent tax on early withdrawals. Individuals also could withdraw funds to help children and grandchildren with a qualified expense.

The basis of a home purchased with the proceeds of a tax-free IRA distribution would be reduced by the amount excluded from income. Upon sale of the home, gain up to the amount of the excludable distribution would be treated as ordinary income and the 10-percent tax on early withdrawals would apply except to the extent such gain is rolled over into an IRA.

Effective Date

The provision would apply to taxable years beginning after the date of enactment.

e. First-time homebuyers' tax credit

Present Law

There is no credit for first-time homebuyers under present law.

Explanation of Provision

The bill would give first-time homebuyers a refundable tax credit of $1000 for the purchase of a principal residence. The amount of the credit would be phased out for taxpayers with adjusted gross income ("AGI") between $31,000 and $41,000. In the case of married people, regardless of filing status, both spouses' AGIs would be combined for purposes of the phaseout. If two or more people purchase the house for use as their principal residence, then the $1,000 credit would be split among them (according to regulations) as long as all of the purchasers are first-time homebuyers and as long as their combined AGIs were used for purposes of the phaseout.

First-time homebuyers are defined as individuals who had no present ownership interest in a principal residence during the 3-year period prior to the acquisition of the property qualifying for the credit. If the individual is married, his or her spouse must also meet the above test in order for the individual to be characterized as a "first-time homebuyer."

Properties for which the purchaser's basis is determined by reference to the adjusted basis of the seller or by application of Code sec. 1014(a) (relating to property acquired from a decedent) would not be eligible for the credit. The size of the credit and the phaseout range would not be indexed for inflation.

Effective Date

The bill would apply to purchases of principal residences after the date of enactment.

f. Social security earnings test

Present Law

Social security benefits are reduced for certain beneficiaries if they have wages or earned income in excess of a certain amount. The amount of the reduction depends on whether or not the beneficiary has attained retirement age. For 1991, the exempt amount in the case of beneficiaries under age 65 is $7,080. For such beneficiaries, benefits are reduced by $1 for each $2 of wages or earnings in excess of the exempt amount. For 1991, the exempt amount in the case of beneficiaries age 65-69 is $9,720, and benefits are reduced for such beneficiaries by $1 for each $3 of wages or earnings in excess of the exempt amount. The reduction does not apply to beneficiaries age 70 or older. The exempt amounts are adjusted each year for inflation.

Explanation of Provision

The bill would increase the exempt amount for persons who have attained retirement age $1,000 per year over a period of 6 years, beginning after 1991. The bill also appropriates funds to pay for the increases in benefits under the provision. Sufficient funds to pay the increase in benefits are to be transferred at least quarterly from the general funds of the Treasury to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The Secretary of the Treasury is to report annually to the Congress and the Secretary of Health and Human Services on the transfers made during the year and the anticipated operation of the provision during the next 5 years. The bill would also require the Secretary of Health and Human Services to submit a study to the Congress by November 1, 1997, relating to whether further amendments relating to deductions of benefits on account of work and the exempt amount are necessary or appropriate.

Effective Date

The increase in the exempt amount would be effective for taxable years ending after 1991.

g. Individual income tax rates

Present Law

For 1991, the individual tax rate schedules are—

If taxable income is	Then income tax equals
Single individuals	
$0–$20,350	15 percent of taxable income.
$20,350–$49,300	$3,052.50 plus 28% of the amount over $20,350.
Over $49,300	$11,158.50 plus 31% of the amount over $49,300.
Heads of households	
$0–$27,300	15 percent of taxable income.
$27,300–$70,450	$4,095 plus 28% of the amount over $27,300.
Over $70,450	$16,177 plus 31% of the amount over $70,450.
Married individuals filing joint returns	
$0–$34,000	15 percent of taxable income.
$34,000–$82,150	$5,100 plus 28% of the amount over $34,000.

If taxable income is	Then income tax equals
Over $82,150	$18,582 plus 31% of the amount over $82,150.
Married individuals filing separate returns	
$0–$17,000	15 percent of taxable income.
$17,000–$41,075	$2,550 plus 28% of the amount over 17,000.
Over $41,075	$9,291 plus 31% of the amount over $41,075.
Trusts and estates	
$0–$3,450	15 percent of taxable income.
$3,450–$10,350	$517.50 plus 28% of the amount over $3,450.
Over $10,350	$2,449.50 plus 31% of the amount over $10,350.

Explanation of Provision

The bill would replace the present law individual income tax rate structure with a new rate structure. The individual rate schedules for the taxable year beginning after the date of enactment would be—

If taxable income is	Then income tax equals
Single individuals	
Not over $19,450	11.25% of taxable income.
Over $19,450 but not over $47,050.	$2,188.12, plus 21% of the excess over $19,450.
Over $47,050	$7,984.12, plus 23.25% of the excess over $47,050.
Heads of households	
Not over $26,050	11.25% of taxable income.
Over $26,050 but not over $67,200.	$2,930.62, plus 21% of the excess over $26,050.
Over $67,200	$11,572.12, plus 23.25% of the excess over $67,200.
Married individuals filing joint returns	
Not over $32,450	11.25% of taxable income.
Over $32,450 but not over $78,400.	$3,650.62, plus 21% of the excess over $32,450.
Over $78,400	$13,300.12, plus 23.25% of the excess over $78,400.
Married individuals filing separate returns	
Not over $16,225	11.25% of taxable income.

If taxable income is	Then income tax equals
Over $16,225 but not over $39,200.	$1,825.31, plus 21% of the excess over $16,225.
Over $39,200	$6,650.06, plus 23.25% of the excess over $39,200.
Trusts and estates	
Not over $3,300	11.25% of taxable income.
Over $3,300 but not over $9,900	$371.25, plus 21% of the excess over $3,300.
Over $9,900	$1,757.25, plus 23.25% of the excess over $9,900.

Effective Date

The provision would be effective for taxable years beginning after the date of enactment.

h. Individual minimum tax

Present Law

An individual taxpayer is subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent and is applied to the taxpayer's alternative minimum taxable income (generally computed by adding preference items to the taxpayer's regular taxable income).

Explanation of Provision

The bill would decrease the alternative minimum tax rate on individuals from 24 percent to 16 percent.

Effective Date

The provision would be effective for taxable years beginning after the date of enactment.

i. Budget provisions

Present Law

The 1990 Budget Act substantially amended the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings). In relevant part, the 1990 Budget Act provides for an automatic sequester of non-exempt spending programs to avoid any Federal deficit increase if increases in direct spending or reductions in revenue are not paid for on a year-by-year basis ("pay-as-you-go").

Explanation of Provision

The bill would direct the Director of the Office of Management and Budget to estimate any reduction in Federal revenues resulting from the bill. Thereafter, the President would order a sequestration with respect to all but exempt accounts of the Federal budget in an amount equal to the estimated shortfall. For these purposes exempt accounts are: (1) any account for the payment of benefits under Title II of the Social Security Act or under section 3(a), 3(f)(3), 4(a) or 4(f) of the Railroad Retirement Act of 1974, and (2) any account for the payment of interest on any obligation of the United States.

Effective Date

The provision would be effective for taxable years beginning after the date of enactment.

9. H.R. 3680, "The Family Tax Relief Act of 1991" (Messrs. Russo, Guarini, Ms. Pelosi, and Mr. Miller of California)

Present Law

Present law does not provide for tax credits based on the number of dependent children. However, taxpayers with dependent children generally are able to claim a personal exemption for these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income in arriving at taxable income. The amount of the personal exemption is $2,150 for 1991, and is adjusted for inflation.

In addition, eligible low-income workers may claim a refundable earned income tax credit (EITC) of up to 16.7 percent (17.3 percent for taxpayers with more than 1 qualifying child) of the first $7,140 of earned income for 1991. The maximum amount of credit for 1991 is $1,192 ($1,235 for taxpayers with more than 1 qualifying child), and this maximum is reduced by 11.93 percent (12.36 percent for taxpayers with more than 1 qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,250. The EITC is not available to workers with earned income (or adjusted gross income, if greater) over $21,245. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

[In percent]

Year	One qualifying child		Two or more qualifying children	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.4	13.141
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation.

As part of the EITC, a supplemental young child credit is available for qualifying children under the age of one year. This "young child credit" rate is 5 percent and the phase-out rate is 3.57 percent. In addition, a supplemental health insurance credit under the EITC is available to taxpayers who provide health insurance coverage for their qualifying children. The health insurance credit rate is 6 percent and the phase-out rate is 4.285 percent. Both supplemental credits are computed on the same base as the ordinary EITC.

Explanation of Provisions

Tax credit

The bill would allow taxpayers to claim a refundable tax credit equal to $350 for each dependent child of the taxpayer under age 18. The $350 figure would be adjusted for inflation occurring after 1991.

Budget-offsetting provisions

The bill would provide for reductions in a number of specified spending categories and for modifications in the Congressional budget process to offset the cost of the proposed tax credit.

Effective Date

The provisions of the bill would be effective for taxable years beginning after December 31, 1991.

10. H.R. 3744, "Economic Growth and Family Tax Freedom Act of 1991" (Messrs. Weber, DeLay, Wolf, Armey, Ramstad, Smith of Texas, Doolittle, Packard, McEwen, Santorum, Zimmer, Cox of California, Walker, Rohrabacher, Boehner, Kyl, Ireland, Broomfield, Dickinson, Cunningham, Barrett, Skeen, Riggs, Tallon, Paxon, Ravenel, Sensenbrenner, Thomas of Wyoming, Walsh, Solomon, and Camp)

a. Tax credit for children

Present Law

Present law does not provide for tax credits based on the number of dependent children. However, taxpayers with dependent children are generally able to claim a personal exemption for these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income to determine taxable income. The amount of the personal exemption is $2,150 for 1991, and is adjusted for inflation.

In addition, eligible low-income workers may claim a refundable earned income tax credit (EITC) of up to 16.7 percent (17.3 percent for taxpayers with more than 1 qualifying child) of the first $7,140 of earned income for 1991. The maximum amount of credit for 1991 is $1,192 ($1,235 for taxpayers with more than 1 qualifying child), and this maximum is reduced by 11.93 percent (12.36 percent for taxpayers with more than 1 qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,250. The EITC is not available to workers with earned income (or adjusted gross income, if greater) over $21,245. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

[In percent]

Year	One qualifying child		Two or more qualifying children	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.4	13.14
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation.

As part of the EITC, a supplemental young child credit is available for qualifying children under the age of one year. This "young child credit" rate is 5 percent and the phase-out rate is 3.57 percent. In addition, a supplemental health insurance credit under the EITC is available to taxpayers who provide health insurance coverage for their qualifying children. The health insurance credit rate is 6 percent and the phase-out rate is 4.285 percent. Both supplemental credits are computed on the same base as the ordinary EITC.

Explanation of Provision

The bill would allow taxpayers to claim a nonrefundable tax credit equal to (1) $1,000 for each qualifying child of the taxpayer who had not reached the age of 6, and (2) $300 for each qualifying child of the taxpayer who had attained the age of 6 but who had not reached the age of 19. A "qualifying child" would be defined as a child under age 19 who resides with the taxpayer (this definition is used in the EITC eligibility rules).

The provision also would provide that the dependent care tax credit (Code sec. 21) would no longer be available for children under age 6.

Effective Date

The provision would apply to taxable years beginning after December 31, 1990.

b. Capital gains tax reduction and indexing

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income, (i.e., 34 percent).

Capital losses are deductible generally only to the extent of capital gains, although individual taxpayers may deduct up to an additional $3,000 of capital losses against ordinary income in any year ($1,500 in the case of a married individual filing a separate return). Individuals may carry over capital losses in excess of this limit to future years indefinitely.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Personal exemption and itemized deduction phaseouts

The deduction for personal exemptions is phased out for taxpayers with adjusted gross incomes (AGIs) above a threshold amount. In addition, the total of otherwise allowable miscellaneous itemized deductions that may be claimed by a taxpayer generally is reduced for taxpayers with AGIs above a threshold amount.

Alternative minimum tax

Taxpayers are subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent (20 percent in the case of corporations) and is applied to the taxpayer's alternative minimum taxable income (generally computed by making adjustments and adding preference items to the taxpayer's regular taxable income).

Indexing

The amount taken into account under present law in computing gain or loss from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Explanation of Provisions

Capital gains

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent.

For purposes of computing a taxpayer's personal exemption and itemized deduction phaseouts, the taxpayer's AGI would be reduced by any net capital gain.

The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill. The adjustment would equal the percentage by which the GNP deflator for the last calendar quarter of the preceding calendar year exceeds the GNP deflator for the last calendar quarter of 1990.

Indexing

In general

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

Indexed assets

The bill generally would provide for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock.[13]

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1991) (the "applicable inflation ratio"). The applicable inflation ratio would not be taken into account unless it is greater than one. In addition, it would be rounded to the nearest one-tenth of one percent. The indexed basis would be the adjusted basis of the asset, multiplied by the applicable inflation ratio.

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[13] Stock in a foreign corporation that is listed on a domestic exchange generally would be treated as an indexed asset.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset would not be taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion would be disregarded in determining the inflation ratio applicable to the disposition of the common stock. In addition, an asset would not be treated as an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

To the extent that an ordinary loss would be created or increased by the provision, the taxpayer would be treated as having a long-term capital loss in an amount equal to the amount of the ordinary loss.

The indexing adjustment generally would not apply to dispositions between related parties. In addition, if the principal purpose of a transfer is to increase an indexing adjustment or a depreciation deduction, the adjustment may be disallowed.

The indexing adjustment would apply for purposes of determining earnings and profits.

Special entities

In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs) and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio generally would be determined every month. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock would be allowed for that month. Where less than 10 percent of the assets are indexed assets in any month, no indexing would be allowed that month for the stock.

In the case of partnerships and S corporations, inflation adjustments made at the partnership and S corporation levels would be passed through to the partners and shareholders.

Effective Date

The provisions generally would apply to sales or exchanges occurring after December 31, 1991. The provision that would provide for the indexing of the limitation on capital losses would apply to tax years beginning after December 31, 1991.

c. Exclusion of gain on the sale of a principal residence

Present Law

In general, a taxpayer may elect to exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale, and (2) has used the residence as a principal residence for three or more years of the five years preceding sale of the residence (sec. 121). The election may be made only once.

Explanation of Provision

The bill would exclude from gross income any gain from the sale of a principal residence (i.e., the bill would repeal the dollar, age, use, and one-time limitations on the exclusion of gain on the sale of a principal residence).

Effective Date

The bill would apply to sales occurring after December 31, 1991, in taxable years ending after that date.

d. Adjust depreciation allowances for certain property

Present Law

Depreciation deductions

A taxpayer is allowed depreciation deductions for the cost of property used in a trade or business. The amount of the depreciation deduction allowed with respect to the cost of any tangible property for a taxable year is determined under the accelerated cost recovery system (ACRS) as modified by the Tax Reform Act of 1986. Under ACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods generally applicable to tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

For purposes of the alternative minimum tax (AMT), tangible personal ACRS property generally is depreciated using the 150-percent declining balance method over useful lives that are generally longer than the applicable recovery periods of the ACRS for regular tax. In addition, for purposes of the adjusted current earnings (ACE) component of the corporate AMT, ACRS property generally is depreciated using the straight line method over these longer useful lives.

Expensing election

In lieu of depreciation, a taxpayer may elect to expense and deduct up to $10,000 of the cost of qualifying property placed in service for the taxable year. For this purpose, qualifying property generally is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $10,000 amount is reduced by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

Explanation of Provisions

Depreciation adjustment for certain property placed in service in taxable years beginning after 1991

Under the bill, in the case of tangible property (other than residential rental property and nonresidential real property) placed in service in a taxable year beginning after 1991, the deduction allowed under ACRS for any taxable year after the year in which the property is placed in service would be determined by multiplying the depreciation allowance allowable for the property for the taxable year (determined without regard to this provision) by the "applicable neutral cost recovery ratio" for the year.

The applicable neutral cost recovery ratio for the year is first determined by dividing (1) the gross national product deflator for the calendar quarter ending in such taxable year which corresponds to the calendar quarter during which the property was placed in service by the taxpayer by (2) the gross national product deflator for the calendar quarter during which the property was placed in service by the taxpayer. This ratio is then multiplied by the number equal to 1.035 to the nth power, where "n" is the number of full years in the period beginning on the first day of the calendar quarter during which the property was placed in service and ending on the day before the beginning of the corresponding calendar quarter ending during the taxable year.

The bill would replace the 200-percent declining balance method of present law with 125-percent declining balance method.

The bill would provide that indexing applies for AMT and ACE purposes. In addition, the depreciation allowances for AMT and ACE purposes would be increased by the applicable percentage of the depreciation differential for the taxable year. The applicable percentage is 20 percent for taxable years beginning after January 1, 1992, and before January 2, 1993, and it would be increased by 10 percentage points for each succeeding taxable year (until it reaches 100 percent). The depreciation differential for the taxable year is equal to the excess of the depreciation deduction for regular tax purposes over the depreciation deduction determined for AMT or ACE purposes.

Phase-in of expensing for certain property placed in service in taxable years beginning after 1996

Under the bill, in the case of tangible property placed in service in a taxable year beginning after 1996, the taxpayer would be allowed to (1) deduct "phase-in deductions" for the year such property is placed in service and (2) reduce the applicable recovery period for such property by the "phase-in number of years." The "phase-in deductions" with respect to any property are the aggregate deductions allowed under ACRS (determined without regard to this provision and the indexing provision described above) for the first phase-in number of years in the applicable recovery period. The "phase-in number of years" with respect to any property is the number of calendar years after 1996 and before the calendar year in which the property is placed in service.

These phase-in provisions would not apply to any property for which the taxpayer so elects. Any election, once made, would be irrevocable.

Effective Dates

The indexing (and related) provision of the bill would be effective for qualifying property placed in service in taxable years beginning after December 31, 1991. The phase-in expensing provision of the bill would be effective for qualifying property placed in service in taxable years beginning after December 31, 1996.

e. Individual retirement arrangements (IRAs)

Present Law

In general

Under certain circumstances, an individual is allowed a deduction for contributions (within limits) to an individual retirement account or an individual retirement annuity (an IRA) (Code sec. 219). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA.

Under present law, the maximum deductible contribution that can be made to an IRA generally is the lesser of $2,000 or 100 percent of an individual's compensation (earned income in the case of self-employed individuals). In addition, a married taxpayer who files a joint return with his or her spouse can make an additional contribution of up to $250 to an IRA established for the benefit of the spouse, if the spouse has no compensation or elects to be treated as having no compensation. A single taxpayer is permitted to make the maximum deductible IRA contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has adjusted gross income (AGI) of less than $25,000. A married taxpayer filing a joint return is permitted to make the maximum deductible IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married couple) is an active participant in an employer-sponsored retirement plan, the maximum IRA deduction is phased out over certain AGI levels. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Nondeductible IRA contributions

Individuals may make nondeductible IRA contributions to the extent deductible contributions are not allowed because of the AGI phaseout and active participant rules. A taxpayer may also elect to make nondeductible contributions in lieu of deductible contributions. Thus, any individual may make nondeductible contributions up to the excess of (1) the lesser of $2,000 or 100 percent of compensation over (2) the IRA deduction claimed by the individual. An individual making nondeductible contributions is required to report the amount of such contributions on his or her tax return. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions are not subject to income tax until withdrawn.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than amounts that represent a return of nondeductible contributions) are includible in income when withdrawn. If an individual withdraws an amount from an IRA during a taxable year and the individual has previously made both deductible and nondeductible IRA contributions, then the amount includible in income for the taxable year is the excess of the amount withdrawn over the portion of the amount withdrawn attributable to investment in the contract (i.e., nondeductible contributions). The amount attributable to nondeductible contributions is the portion of the amount withdrawn that bears the same ratio to the amount withdrawn as the total amount of nondeductible contributions bears to the total current value of all IRAs of the individual.

Withdrawals from an IRA prior to age 59½, death, or disability are generally subject to an additional 10-percent income tax (sec. 72(t)). The 10-percent additional income tax is intended to recapture at least a portion of the tax benefit of the IRA. The 10-percent additional income tax does not apply to withdrawals that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of the taxpayer and the taxpayer's designated beneficiary. A similar early withdrawal tax applies to withdrawals from qualified retirement plans and deferred annuities.

Explanation of Provisions

IRA plus accounts

The provision would permit individuals to establish and make nondeductible contributions to IRA plus accounts. Contributions to IRA plus accounts could be made regardless of income or other retirement plan coverage. Contributions to the IRA plus would be limited to $2,000 per taxpayer per year, less the amount of deductible contributions made to a deductible IRA. The $2,000 limit would be increased to $3,000 for taxable years beginning after 1996. In the case of married taxpayers, each spouse could contribute up to $2,000 if the combined compensation of the spouses was at least as great as the IRA plus contributions. Contributions could be made by an individual to an IRA plus account after the individual reaches age 70½.

No tax or penalty would be imposed on IRA plus distributions attributable to the employee's being disabled, or on distributions made on or after the date on which the individual attains age 59½ or dies, provided such funds are withdrawn at least 5 years after the date of the creation of the IRA plus.

Rollovers from normal IRAs to an IRA plus would be permitted, although the amount representing previously-deductible contributions would be subject to income tax. Balances originating from qualified retirement plans other than IRAs could not be rolled over into an IRA plus account. In the case of a rollover from a normal IRA made on or before the earlier of (1) the date on which the individual attains age 55, or (2) June 30, 1993, the tax on the includible amount of the rollover would be spread ratably over the 4-taxable year period beginning with the taxable year in which the amount was paid out of the IRA. Amounts that are rolled over could not be distributed tax-free until 5 years after the date of the rollover.

Penalty-free IRA withdrawals for qualified expenses

The provision would allow certain individuals to receive a tax-free withdrawal of up to 25 percent of their IRA account for the purchase of a first home, certain education expenses, and certain medical expenses. Amounts in excess of the 25 percent limit would be subject to income tax, but would not be subject to the additional 10-percent tax on early withdrawals. Individuals also could withdraw funds to help children and grandchildren with a qualified expense.

The basis of a home purchased with the proceeds of a tax-free IRA distribution would be reduced by the amount excluded from income. Upon sale of the home, gain up to the amount of the excludable distribution would be treated as ordinary income and the 10-percent tax on early withdrawals would apply except to the extent such gain is rolled over into an IRA.

Effective Date

The provision would apply to taxable years beginning after December 31, 1991.

f. Passive loss rules

Present Law

Under present law, the passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. Deductions that are suspended under this rule are carried forward and treated as deductions from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate, and rental activities. A rental activity is treated as a passive activity, regardless of the level of the taxpayer's participation. (A special rules permits the deduction of up to $25,000 of losses from certain rental real estate activities, even though they are considered passive, for taxpayers with adjusted gross incomes of $100,000 or less. This deduction is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000.)

Explanation of Provision

The bill would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of individual and corporate taxpayers "engaged in the real property business". Rental real property activities would be treated the same as nonrental activities, for purposes of determining what is an activity and whether an activity is passive. Under the bill, the taxpayer's material participation in a rental real property activity (or aggregated real property activities) would determine whether losses and credits therefrom are passive and are subject to the limitation of the passive loss rule. Rental activities involving property other than real property would continue to be treated as passive as under present law, regardless of whether the taxpayer materially participates in them.

The bill would provide that a individual is engaged in the real property business if the taxpayer spends at least 50 percent of his working time and more than 500 hours a year in real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, brokerage, appraisal or finance operations. Whether a corporation is engaged in the real property business is determined by the involvement of shareholders or employees in the real property activities of the corporation.

Effective Date

The bill would be effective with respect to taxable years beginning after December 31, 1991. Thus, the provisions of the bill would apply to activities acquired by the taxpayer on or before December 31, 1991, as well as those acquired after that date.

g. Enterprise zones

Present Law

Targeted geographic areas

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, the provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas. Similarly, for purposes of the low-income housing credit, certain geographic areas are designated as high cost or difficult to develop areas for the purpose of increasing the rate of credit applicable to such areas. In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States as a means to encourage the conduct of trades or businesses within these areas.

Tax credits for employees

Under present law, the income tax liability of an employee does not vary based on where the employee performs services in the

United States on behalf of an employer. However, an eligible individual who maintains a home for one or more qualifying children is allowed an advance refundable income tax credit based on the earned income of the individual and the number of qualifying children.

The targeted jobs tax credit under present law provides an income tax credit to employers for a portion of the wages paid to certain employees, who generally are either economically disadvantaged or participating in a specific education or rehabilitation program.

Capital gains

Net capital gains are taxed as ordinary income under present law, subject to a maximum marginal rate of 28 percent in the case of individuals. Before 1987, net capital gains were taxed at a reduced rate. All taxpayers other than corporations could reduce net capital gains by 60 percent, and the remainder was taxed as ordinary income—effectively establishing a maximum 20-percent tax rate. The maximum tax rate for net capital gains of corporations was 28 percent. This reduction in tax for capital gains was treated as a preference item for purposes of computing the minimum tax.

Expensing of certain investments

There is no provision under present law that allows the amount of an investment to be expensed (i.e., deducted for the year in which the investment occurs) based on the location of the investment. Present law, however, provides that in lieu of a depreciation deduction, a taxpayer (other than an estate or trust) may elect to deduct all or a portion of the cost of qualifying property for the taxable year in which the property is placed in service. The maximum amount that may be expensed under this provision for any taxable year is $10,000. In general, qualifying property is any tangible personal property that is predominantly used in the active conduct of a trade or business.

Nontax provisions

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on goods imported into a foreign trade zone until the time that the goods leave the foreign trade zone for shipment to other areas of the United States.

Regulatory flexibility

Under present law, government agencies must follow certain procedures in promulgating regulations that are designed to ease the regulatory burden on small businesses, small nonprofit organizations, and small governmental jurisdictions.

Housing and Community Development Act of 1987

Under Title VII of the Housing and Community Development Act of 1987, the Secretary of Housing and Urban Development (HUD) may designate not more than 100 nominated areas as enterprise zones (42 U.S.C. sec. 11501 et seq.).[14] An area may be so designated after being nominated by one or more local governments and the State in which it is located. An area may be designated as an enterprise zone only if it meets certain requirements concerning area boundaries, population, unemployment, poverty, and other signs of economic distress. At least one-third of the designated enterprise zones must be within rural areas.

No area may be designated as an enterprise zone unless the local government and the State (or, in the case of a nominated area on an Indian reservation, the reservation governing body) in which the area is located provide commitments that such governments will follow a specified course of action designed to reduce various burdens borne by employers or employees in the nominated area. An enterprise zone designation generally is to remain in effect for 24 years.

Explanation of Provisions

Designation of enterprise zones

H.R. 3744 would authorize the Secretary of HUD to designate up to 50 enterprise zones from areas nominated by State and local governments (or an Indian reservation governing body). The designations would be made over a four-year period, with not more than 15 designations being made during each of the first three years. At least one-third of the designated zones would be required to be in rural areas. The designation of an area as an enterprise zone generally would be effective for 25 years.

Designated enterprise zones would be required to meet certain requirements concerning area boundaries, population, unemployment, poverty, and other signs of economic distress. In addition, the local government and State in which the zones are located would be required to agree to follow a specified course of action designed to benefit employers and employees in the zones.

The Secretary of HUD would be required to designate enterprise zones from eligible areas on the basis of the following selection criteria: (1) the strength and quality of promised contributions by State and local governments relative to their fiscal ability; (2) the effectiveness and enforceability of the proposed courses of action by the State and local governments; (3) the level of commitments by private entities; (4) other factors, including relative distress; and (5) reasonable geographic distribution of enterprise zones.

Employment tax credit

The bill would provide a 5-percent refundable tax credit to certain enterprise zone employees for the first $10,500 of wages. The maximum credit would be $525; it would be phased out between $20,000 and $25,000 of total wages. The credit would be reduced for individuals subject to the alternative minimum tax.

To qualify for the credit, the employee would be required to perform substantially all of his or her services within an enterprise zone for an enterprise zone business, generally meaning a business

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[14] Prior to January 1, 1989, HUD received 270 nominations of areas seeking to be designated as enterprise zones. Thus far, no area has been designated as an enterprise zone.

with 80 percent of its gross income attributable to active business activities conducted within the zone.

Exclusion of enterprise zone capital gain

The bill would exclude from income certain long-term capital gain realized from the disposition of enterprise zone property, generally defined as any property (other than collectibles) located in an enterprise zone and used in an enterprise zone business. The property must have constituted enterprise zone property for at least two years prior to disposition. The gain exclusion would not be a preference item for purposes of the alternative minimum tax.

Deduction for purchases of enterprise zone stock

Under the bill, individuals could elect to deduct up to $100,000 per year of the purchase price of enterprise zone stock, subject to a $500,000 lifetime limitation. Any gain on the sale of the stock would be recaptured as ordinary income. In addition, the tax benefit of the deduction would be reduced if the stock were held less than five years when sold. The deduction would not be treated as a preference item for purposes of computing an individual's alternative minimum tax.

In order for stock to qualify as enterprise zone stock, the following requirements would have to be met: (1) the stock must be common stock; (2) the amount of the proceeds must be used by the issuer within 12 months to acquire enterprise zone property; and (3) the issuer must be a subchapter C corporation (a) which does not have more than one class of stock, (b) which is engaged solely in the conduct of an enterprise zone business, (c) which does not own or lease more than $50 million of property, and (d) more than 20 percent of whose stock is owned by individuals, partnerships, estates or trusts. In addition, a corporation could not issue more than $50 million of enterprise zone stock.

Nontax provisions

Foreign trade zones

The bill would require the Foreign Trade Zone Board to consider on a priority basis the processing of any applications that involve the establishment of a foreign-trade zone in an enterprise zone.

Regulatory flexibility

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified enterprise zone business, and certain other enterprises. The bill also would provide for waiver or modification of Federal agency rules to foster economic development activities in enterprise zones.

Repeal of Title VII of 1987 Housing Act

The bill would repeal Title VII of the Housing and Community Development Act of 1987.

Effective Date

The tax provisions would be effective for taxable years ending after December 31, 1991. The nontax provisions generally would be effective upon enactment.

11. S. 1921, "The Tax Fairness and Savings Incentive Act of 1991" (Senators Bentsen, Adams, Akaka, Baucus, Boren, Breaux, Burdick, Daschle, DeConcini, Dodd, Ford, Hatch, Inouye, Johnston, Lieberman, Mikulski, Pryor, Roth, and Symms)

a. Family tax credits

Present Law

Present law does not provide for tax credits based on the number of dependent children. However, taxpayers with dependent children generally are able to claim a personal exemption for these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income in arriving at taxable income. The amount of the personal exemption is $2,150 for 1991, and is adjusted for inflation.

In addition, eligible low-income workers may claim a refundable earned income tax credit (EITC) of up to 16.7 percent (17.3 percent for taxpayers with more than 1 qualifying child) of the first $7,140 of earned income for 1991. The maximum amount of credit for 1991 is $1,192 ($1,235 for taxpayers with more than 1 qualifying child), and this maximum is reduced by 11.93 percent (12.36 percent for taxpayers with more than 1 qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,250. The EITC is not available to workers with earned income (or adjusted gross income, if greater) over $21,245. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

[In percent]

Year	One qualifying		Two or more qualifying children	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.4	13.14
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation.

As part of the EITC, a supplemental young child credit is available for qualifying children under the age of one year. This "young child credit" rate is 5 percent of earned income and the phase-out rate is 3.57 percent. In addition, a supplemental health insurance credit under the EITC is available to taxpayers who provide health insurance coverage for their qualifying children. The health insurance credit rate is 6 percent of earned income and the phase-out rate is 4.285 percent. Both supplemental credits are computed on the same base as the ordinary EITC.

Explanation of Provision

The bill would allow taxpayers to claim a refundable tax credit equal to $300 for each qualifying child of the taxpayer. A "qualifying child" would be defined as a child under age 19 who resides with the taxpayer (this definition is used in the EITC eligibility rules). The $300 figure would be adjusted for inflation for taxable years after 1991.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991.

b. Individual retirement arrangements

Present Law

Under present law, under certain circumstances, an individual is allowed to deduct contributions (up to the lesser of $2,000 or 100 percent of the individual's compensation or earned income) to an individual retirement arrangement (IRA). The amounts held in an IRA, including earnings on contributions, generally are not included in gross income until withdrawn. Withdrawals prior to attainment of age 59½ generally are subject to an additional 10-percent early withdrawal tax.

The $2,000 deduction limit is phased out over certain adjusted gross income (AGI) thresholds if the individual or the individual's spouse is an active participant in an employer-sponsored retirement plan. An individual may make nondeductible IRA contributions (up to the $2,000 or 100 percent of compensation limit) to the extent the individual is not permitted to make or does not make deductible IRA contributions.

The IRA provisions were originally enacted in the Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA, an individual was permitted to make deductible IRA contributions only if the individual was not an active participant in an employer-sponsored retirement plan. The limit on IRA deductions was the lesser of $1,500 or 15 percent of compensation (or earned income, in the case of a self-employed individual).

The Economic Recovery Tax Act of 1981 increased the IRA deduction limit to its current level and removed the restriction on IRA contributions by individuals who were active participants in employer-sponsored plans. The IRA rules in their current form were enacted as part of the Tax Reform Act of 1986.

Explanation of Provision

The bill would restore the deductibility of IRA contributions for all taxpayers under the rules in effect prior to the Tax Reform Act of 1986 and would index for inflation the limits on contributions to IRAs. In addition, the bill would create a new special IRA to which a taxpayer could make nondeductible contributions. Withdrawals from a special IRA would not be includible in income if attributable to contributions that had been held by the special IRA for at least 5 years. The limits on contributions to deductible IRAs and special IRAs and the limits on elective deferrals under certain other tax-favored arrangements (e.g., section 401(k) plans) would be coordinated.)

The bill would permit amounts in IRAs to be transferred to a special IRA. Amounts so transferred generally would be includible in income as if the amounts had been withdrawn from the IRA, except that the early withdrawal tax would not apply. In the case of transfers made before January 1, 1994, the amount includible in income would be spread over the 4 taxable years following the transfer.

The bill would allow withdrawals from an IRA, from a special IRA, and from elective deferrals under (1) a qualified cash or deferred arrangement (sec. 401(k) plan), (2) a tax-sheltered annuity (sec. 403(b)), or (3) a section 501(c)(18) plan. The 10-percent additional income tax on early withdrawals would not apply to such withdrawals to the extent the amount withdrawn is used for the purchase of a first home, for certain education expenses, or for catastrophic medical expenses (i.e., medical expenses in excess of 7.5 percent of AGI). The bill also would provide that the exception to the early withdrawal tax for distributions after age 59½ does not apply to deductible IRAs unless the contributions withdrawn have been in the IRA for at least 5 years before withdrawal.

Effective Date

The IRA provisions of the bill generally would be effective for taxable years beginning after December 31, 1991, except that the new exceptions to the early withdrawal tax would apply to distributions after the date of enactment.

c. Reduction in defense spending

The bill would provide for a reduction in defense spending to offset the cost of the proposed tax reduction provisions.

12. S. 1865, "Defense Tax Rebate Act" (Senator Roth)

a. Individual income tax rates

Present Law

For 1991, the individual tax rate schedules are—

If taxable income is	Then income tax equals
Single individuals	
$0–$20,350	15 percent of taxable income.
$20,350–$49,300	$3,052.50 plus 28% of the amount over $20,350.
Over $49,300	$11,158.50 plus 31% of the amount over $49,300.
Heads of households	
$0–$27,300	15 percent of taxable income.
$27,300–$70,450	$4,095 plus 28% of the amount over $27,300.
Over $70,450	$16,177 plus 31% of the amount over $70,450.
Married individuals filing joint returns	
$0–$34,000	15 percent of taxable income
$34,000–$82,150	$5,100 plus 28% of the amount over $34,000.
Over $82,150	$18,582 plus 31% of the amount over $82,150.
Married individuals filing separate returns	
$0–17,000	15 percent of taxable income.
$17,000–$41,075	$2,550 plus 28% of the amount over 17,000.
Over $41,075	$9,291 plus 31% of the amount over $41,075.
Trusts and estates	
$0–$3,450	15 percent of taxable income.
$3,450–$10,350	$517.50 plus 28% of the amount over $3,450.
Over $10,350	$2,449.50 plus 31% of the amount over $10,350.

Explanation of Provision

The bill would replace the present-law individual income tax rate structure with a new rate structure. The individual rate schedules for 1997 would be—

If taxable income is	Then income tax equals
Single individuals	
$0–$20,350	12 percent of taxable income.
$20,350–$49,300	$2,442 plus 25% of the amount over $20,350.
$49,300–$1,000,000	$9,679.50 plus 28% of the amount over $49,300.
Over $1,000,000	$275,875.50 plus 31% of the amount over $1,000,000.
Heads of households	
$0–$27,300	12 percent of taxable income.
$27,300–$70,450	$3,7276 plus 25% of the amount over $27,300.
$70,450–$1,000,000	$14,063.50 plus 28% of the amount over $70,450.
Over $1,000,000	$275,247.50 plus 31% of the amount over $1,000,000.
Married individuals filing joint returns	
$0–$34,000	12 percent of taxable income.
$34,000–$82,150	$4,080 plus 25% of the amount over $34,000.
$82,150–$1,000,000	$16,117.50 plus 28% of the amount over $82,150.
Over $1,000,000	$273,115.50 plus 31% of the amount over $1,000,000.
Married individuals filing separate returns	
$0–$17,000	12 percent of taxable income.
$17,000–$41,075	$2,040 plus 25% of the amount over $17,000.
$41,075–$1,000,000	$8,058.75 plus 28% of the amount over $41,075.
Over $1,000,000	$276,557.75 plus 31% of the amount over $1,000,000.
Trusts and estates	
$0–$5,450	12 percent of taxable income.
$5,450–$13,500	$654 plus 25% of the amount over $5,450.
$13,500–$1,000,000	$2,666.50 plus 28% of the amount over $13,500.
Over $1,000,000	$303,3549 plus 31% of the amount over $1,000,000.

The bracket thresholds above are expressed at 1990 levels and would be adjusted for inflation to 1997 levels.

The bill would phase in the new rate structure for taxable years 1992-1996. For example, for calendar year taxpayers, the marginal rate brackets will be the following:

For calendar year:

[In percent]

1992	1993	1994	1995	1996	1997
14.875	14.375	13.875	13.375	12.875	12
27.875	27.375	26.875	26.375	25.875	25
30.875	30.375	29.875	29.375	28.875	28
31	31	31	31	31	31

Finally, the bill would modify the withholding tables and procedures for individuals to reflect the changes it would make to the individual income tax rate structure.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1991.

b. Individual retirement arrangements

Present Law

Under present law, under certain circumstances, an individual is allowed to deduct contributions (up to the lesser of $2,000 or 100 percent of the individual's compensation or earned income) to an individual retirement arrangement (IRA). The amounts held in an IRA, including earnings on contributions, generally are not included in gross income until withdrawn. Withdrawals prior to attainment of age 59½ are generally subject to an additional 10-percent early withdrawal tax.

The $2,000 deduction limit is phased out over certain adjusted gross income (AGI) thresholds if the individual or the individual's spouse is an active participant in an employer-sponsored retirement plan. An individual may make nondeductible IRA contributions (up to the $2,000 or 100 percent of compensation limit) to the extent the individual is not permitted to make or does not make deductible IRA contributions.

Explanation of Provisions

The bill would increase the deductible IRA contribution limit for inflation in $500 increments.

The bill would restore the deductibility of IRA contributions for all taxpayers under the rules in effect prior to the Tax Reform Act of 1986 and would index for inflation the limits on contributions to IRAs. In addition, the bill would create a new special IRA to which a taxpayer could make nondeductible contributions. Withdrawals from a special IRA would not be includible in income if attributable to contributions that had been held by the special IRA for at least 5 years. The limits on contributions to deductible IRAs and special IRAs and the limits on elective deferrals under certain other tax-favored arrangements (e.g., section 401(k) plans) would be coordinated.

The bill would permit amounts in IRAs to be transferred to a special IRA. Amounts so transferred generally would be includible in income as if the amounts had been withdrawn from the IRA, except that the early withdrawal tax would not apply. In the case of transfers made before January 1, 1994, the amount includible in income is spread over the 4 taxable years following the transfer.

The 10-percent additional income tax on early withdrawals would not apply to withdrawals from an IRA and from elective deferrals under (1) a qualified cash or deferred arrangement (sec. 401(k) plan), (2) a tax-sheltered annuity (sec. 403(b)), or (3) a section 501(c)(18) plan to the extent the amount withdrawn is used for the purchase of a first home or for certain education expenses. The bill would also extend the exception for withdrawals to pay catastrophic medical expenses (i.e., medical expenses in excess of 7.5 percent of AGI) to IRAs. The bill would also provide that the exception to the early withdrawal tax for distributions after age 59½ does not apply to deductible IRAs unless the contributions withdrawn have been in the IRA for at least 5 years before withdrawal.

Effective Date

The provisions of the bill would generally be effective for taxable years beginning after December 31, 1991, except that the new exceptions to the early withdrawal tax would apply to distributions after the date of enactment.

c. Incremental investment tax credit

Present Law

Taxpayers are allowed to offset all or a portion of their tax liabilities with certain tax credits, including the general business credit. Special rules apply to the application of the general business credit. These rules include (1) the taxable income limitation of section 38(c), (2) the carryover rules of section 39, (3) the at-risk rules of section 49, (4) the recapture rules of section 50(a) (adjusted in the case of 3-year property), (5) the disallowance rules of section 50(b), and (6) the basis adjustment rules of section 50(c).

One component of the general business credit is the investment tax credit. Under present law, the investment tax credit is a 10-percent credit available for certain rehabilitation expenditures, certain reforestation expenditures, and the acquisition of certain energy property. Prior to the enactment of the Tax Reform Act of 1986, the investment tax credit generally was available for up to 10 percent of a taxpayer's investment in certain tangible depreciable property (generally, not including buildings or structures. The Tax Reform Act of 1986 repealed the investment tax credit for most investments in qualified property.

Explanation of Provision

The bill would provide a 10-percent income tax credit for increasing the amount invested in new manufacturing and other productive equipment.

Under the bill, the amount of the credit for any taxable year would equal 10 percent of the excess (if any) of (1) the aggregate bases of qualified manufacturing and productive equipment properties placed in service during such year, over (2) the base amount for such taxable year. The base amount generally would be determined by multiplying the average gross receipts of the taxpayer for the preceding 4 taxable years by a ratio the numerator of which is the aggregate bases of qualified manufacturing and productive equipment properties placed in service during taxable years beginning after 1986 and before 1991 and the denominator of which is the aggregate gross receipts of the taxpayer for taxable years beginning after 1986 and before 1991. In no event shall the base amount be less than 50 percent of the amount of the aggregate bases of qualified manufacturing and productive equipment properties placed in service during such year.

The term "qualified manufacturing and productive equipment property" would be defined as any property that (1) is used as an integral part of the manufacture or production of tangible personal property; (2) is tangible property to which section 168 applies; and (3) is section 1245 property (thereby excluding buildings and the structural components of a building). In addition, in order for property to be considered qualified manufacturing and productive equipment property, the construction, reconstruction, or erection of the property must be completed by the taxpayer, or, in the case of property acquired by the taxpayer, the original use of the property must commence with the taxpayer. Under a special rule, computer software that is used to control or monitor a manufacturing or production process is treated as qualified manufacturing and productive equipment property if a depreciation or amortization deduction is allowable with respect to the software.

Property qualifying for the energy credit or the rehabilitation credit of present law would not be taken into account for purposes of the new credit unless the taxpayer elects otherwise.

The new credit would be a component of the investment tax credit under present law and, as such, the credit would be subject to special rules applicable to the general business credit.

Effective Date

The bill would apply to property acquired by a taxpayer after December 31, 1991, and property the construction, reconstruction, or erection of which is completed by a taxpayer after December 31, 1991, but only to the extent of the basis that is attributable to construction, reconstruction, or erection after December 31, 1991.

d. Modifications to social security benefits

Present Law

Earnings test

Social security benefits are reduced for certain beneficiaries if they have wages or earned income in excess of a certain amount. The amount of the exemption depends on whether the beneficiary has attained retirement age. For 1991, the exempt amount in the case of beneficiaries under age 65 is $7,080. For such beneficiaries, benefits are reduced by $1 for each $2 of wages or earnings in excess of the exempt amount. For 1991, the exempt amount in the case of beneficiaries age 65-69 is $9,720, and benefits are reduced for such beneficiaries by $1 for each $3 of wages or earnings in excess of the exempt amount. The reduction does not apply to beneficiaries age 70 or older. The exempt amounts are adjusted each year for inflation.

Delayed retirement credit

Social security benefits are increased if the worker delays retirement. A credit for delayed retirement is due a worker for each month the worker: (1) was fully insured, (2) had attained age 65 but was not yet age 70, and (3) did not receive benefits because the worker had not filed an application or was working. In general, each monthly credit serves as a basis for increasing the monthly benefits by 1/12 of 1 percent for workers who attained age 62 before 1979 and by 1/4 of 1 percent for workers attaining age 62 from 1978 through 1986. Beginning with workers who attain age 65 in 1990 (i.e., age 62 in 1987) the increment for delaying retirement past the normal retirements age will increase by 1/2 of 1 percent every second year until reaching 8 percent per year of delayed retirement for workers attaining age 65 after 2007.

Explanation of Provisions

Earnings test

The bill would temporarily increase the otherwise applicable exempt amount for persons who have attained retirement age (i.e., 65 for 1991) by $3,000, and then would repeal the earnings test for individuals who have attained retirement age (rather than age 70). The benefit reduction of $1 for each $2 of earnings would then apply only to persons below retirement age, as under present law.

Delayed retirement credit

The bill would also accelerate the increase in the delayed retirement credit so that it is 8 percent in 1993.

Effective Date

The temporary increase in the exemption amount would be effective beginning in 1992, and the repeal of the earnings test for individuals who have attained retirement age would be effective in 1997.

B. Personal Exemption; Standard Deduction; (Child and Earned Income Tax Credits)

1. H.R. 1277, Increase in Personal Exemption (Messrs. Wolf, Hastert, Dickinson, Lightfoot, Walsh, Cunningham, Ramstad, Klug, Hansen, Doolittle, Dornan of California, Weldon, Barrett, Smith of Texas, Cox of California, Holloway, McEwen, Bilirakis, and Inhofe)

Present Law

Personal exemption

Taxpayers are allowed a personal exemption for themselves (and spouse, in the case of a joint return) and for each dependent of the taxpayer. The exemption is structured as a deduction in determining taxable income. The level of the personal exemption was set at $2,000 for taxable years beginning in 1989 and has been indexed for inflation in subsequent years. For taxable years beginning in 1991, the personal exemption is $2,150.

Rounding rules for indexed amounts

In the case of the personal exemption, the standard deduction, the threshold for the limitation on itemized deductions, the basic standard deduction in the case of certain minor dependents, and the break points for the individual income tax brackets, if any indexed amount is not a multiple of $50, then it is rounded down to the next lowest multiple of $50.

Explanation of Provisions

Increase in personal exemption for certain dependent children

The bill would increase the personal exemption to $3,500 for dependent children under the age of 18 at the end of the taxable year. This amount is indexed for inflation in subsequent years.

Change in rounding rules for indexed amounts

In the case of the personal exemption, the standard deduction, the threshold for the limitation on itemized deductions, the basic standard deduction in the case of certain minor dependents, and the break points for the individual income tax brackets, if any indexed amount is not a multiple of $10, then it would be rounded to the nearest multiple of $10.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1991.

2. H.R. 2633, Supplemental Young Child Tax Credit (Mr. Wolf)

Present Law

Eligible low-income workers may claim a refundable earned income tax credit (EITC) of up to 16.7 percent (17.3 percent for taxpayers with more than 1 qualifying child) of the first $7,140 of earned income for 1991. The maximum amount of credit for 1991 is

$1,192 ($1,235 for taxpayers with more than 1 qualifying child), and this maximum is reduced by 11.93 percent (12.36 percent for taxpayers with more than 1 qualifying child) of earned income (or adjusted gross income, if greater) in excess of $11,250. The EITC is not available to workers with earned income (or adjusted gross income, if greater) over $21,245. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

[In percent]

Year	One qualifying child		Two or more qualifying children	
	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1992	17.6	12.57	18.4	13.14
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation.

As part of the EITC, a supplemental young child credit is available for qualifying children under the age of one year. This "young child credit" rate is 5 percent and the phase-out rate is 3.57 percent. In addition, a supplemental health insurance credit under the EITC is available to taxpayers who provide health insurance coverage for their qualifying children. The health insurance credit rate is 6 percent and the phase-out rate is 4.285 percent. Both supplemental credits are computed on the same base as the ordinary EITC.

Explanation of Provision

The bill would replace the present-law supplemental young child credit component of the EITC with an expanded supplemental young child credit available to taxpayers with qualifying children under the age of five. The credit equals 5 percent of earned income up to $10,000 for each qualifying child. The maximum amount of the credit is $500 for each qualifying child and the total amount of credit is phased out ratably for taxpayers with adjusted gross income (AGI) between $50,000 and $60,000 (if greater, earned income would be substituted for AGI). Taxpayers claiming the expanded supplemental young child credit are not permitted to claim the dependent care credit for expenses related to these children. The maximum amount of earned income on which the credit may be claimed and the threshold above which the credit is phased out would be adjusted for inflation.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1991.

3. H.R. 2714, Increase in Personal Exemption (Mr. Crane)

Present Law

Under present law, taxpayers are allowed a personal exemption for themselves (and spouse, in the case of a joint return) and for each dependent of the taxpayer. The level of the personal exemption was set at $2,000 for taxable years beginning in 1989 and has been indexed for inflation in subsequent years. For taxable years beginning in 1991, the personal exemption is $2,150.

Explanation of Provision

The bill would increase the personal exemption for 1991 to $4,000. This amount would be indexed for inflation in subsequent years.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1990.

4. H.R. 3148, Increase in Personal Exemption for Certain Dependent Children; Change in Individual Income Tax Rates (Mrs. Schroeder)

Present Law

Personal exemption

Taxpayers are allowed a personal exemption for themselves (and spouse, in the case of a joint return) and for each dependent of the taxpayer. The exemption is structured as a deduction in determining taxable income. The level of the personal exemption was set at $2,000 for taxable years beginning in 1989 and has been indexed for inflation in subsequent years. For taxable years beginning in 1991, the personal exemption is $2,150.

Rounding rules for indexed amounts

In the case of the personal exemption, the standard deduction, the threshold for the limitation on itemized deductions, the basic standard deduction in the case of certain minor dependents, and the break points for the individual income tax brackets, if any indexed amount is not a multiple of $50, then it is rounded down to the next lowest multiple of $50.

Individual income tax rates

For 1991, the individual tax rate schedules are—

If taxable income is	Then income tax equals
Single individuals	
$0–$20,350	15 percent of taxable income.
$20,350–$49,300	$3,052.50 plus 28% of the amount over $20,350
Over $49,300	$11,158.50 plus 31% of the amount over $49,300.
Heads of household	
$0–$27,300	15 percent of taxable income.
$27,300–$70,450	$4,095 plus 28% of the amount over $27,300.
Over $70,450	$16,177 plus 31% of the amount over $70,450.
Married individuals filing joint returns	
$0–$34,000	15 percent of taxable income.
$34,000–$82,150	$5,100 plus 28% of the amount over $34,000.
Over $82,150	$18,582 plus 31% of the amount over $82,150.
Married individuals filing separate returns	
$0–17,000	15 percent of taxable income.
$17,000–$41,075	$2,550 plus 28% of the amount over 17,000.
Over $41,075	$9,291 plus 31% of the amount over $41,075.
Trusts and estates	
$0–$3,450	15 percent of taxable income.
$3,450–$10,350	$517.50 plus 28% of the amount over $3,450.
Over $10,350	$2,449.50 plus 31% of the amount over $10,350.

Surtax on higher-income individuals

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

Explanation of Provisions

Increase in personal exemption for certain dependent children

The bill would increase the personal exemption to $3,500 for dependent children under the age of 18 at the end of the taxable year. This amount would be indexed for inflation in subsequent years.

Change in rounding rules for indexed amounts

In the case of the personal exemption, the standard deduction, the threshold for the limitation on itemized deductions, the basic standard deduction in the case of certain minor dependents, and the break points for the individual income tax brackets, if any indexed amount is not a multiple of $10, then it would be rounded to the nearest multiple of $10.

Individual income tax rates

The bill would create a 36-percent bracket for taxable incomes above: $90,000 (unmarried individuals filing single returns); $128,000 (unmarried individuals filing as heads of households); $150,000 (married individuals filing joint returns); $75,000 (married individuals filing separate returns); and $18,000 (estates and trusts). These thresholds are expressed at 1990 levels and would be adjusted for inflation to 1992 levels. The bill also would increase the tax rate for personal holding companies from 28 percent to 36 percent.

Surtax on higher-income individuals

The bill would apply a surtax to individuals (including estates and trusts) with taxable income over $500,000. The rate of the tax would vary between 5-percent and 10-percent.

In the case of individuals paying the regular income tax, the surtax would be 5-percent of the regular tax imposed for the taxable year attributable to taxable income above $500,000. However, the rate of the surtax would be increased above 5-percent by 0.05 percentage points for each $5,000 of taxable income over $500,000. For individuals with taxable income above $1,000,000 the surtax would be 10 percent of the regular tax imposed.

In the case of individuals paying the minimum tax the surtax would be 1.2-percent of the alternative minimum tax imposed for the taxable year attributable to alternative minimum taxable income in excess of $500,000. This surtax would also be increased ratably by 0.05 percentage points for each $5,000 of alternative minimum taxable income over $500,000. For individuals with alternative minimum taxable income above $1,000,000 the surtax would be 2.4-percent of the alternative minimum tax imposed.

In addition, the surtaxes would apply to the 28-percent rate applicable to capital gains income.

Effective Date

Generally, the bill would be effective for taxable years beginning after December 31, 1991.

5. H.R. 3202, "Tax Reduction and Simplification Act of 1991" (Messrs. Panetta, Kolter, Lipinski, and Lawrence Smith)

Present Law

Standard deduction

An individual who does not itemize deductions for Federal income tax purposes is allowed a standard deduction that generally is based on the filing status of the individual. For taxable years beginning in 1991, the basic standard deduction is as follows:

Filing status	Standard deduction
Married individuals filing jointly and surviving spouses	$5,700
Heads of household	5,000
Single individuals	3,400
Married individuals filing separately	2,850

Present law also provides an additional standard deduction for individuals who are age 65 or older and for individuals who are blind. For taxable years beginning in 1991, the additional standard deduction is $650 in the case of a married individual (whether or not filing jointly) and $850 in the case of a single individual. Both the basic standard deduction and the additional standard deduction are adjusted for inflation.

Limitation on itemized deductions

An individual who does not elect the standard deduction is allowed itemized deductions for certain nonbusiness expenses, such as State and local taxes, home mortgage interest, certain unreimbursed medical expenses, certain casualty and theft losses, and charitable contributions. Under present law, the total itemized deductions (other than the deductions allowed for medical expenses, casualty and theft losses and investment interest) of an individual that are allowed for any taxable year are reduced by an amount equal to 3 percent of the taxpayer's adjusted gross income in excess of $100,000 ($50,000 in the case of a married individual filing a separate return). In no event may the reduction in itemized deductions exceed 80 percent of the otherwise allowable itemized deductions (other than the deductions allowed for medical expenses, casualty and theft losses and investment interest). The $100,000 threshold is adjusted for inflation for taxable years beginning after 1991. This limitation on itemized deductions will not apply to taxable years beginning after December 31, 1995.

Explanation of Provisions

Increase in basic standard deduction and additional standard deduction for dependents

The bill would increase the basic standard deduction as follows:

Filing status	Standard deduction
Married individuals filing jointly and surviving spouses	$6,090
Heads of household	5,390
Single individuals	3,635
Married individuals filing separately	3,045

In addition, the bill would provide an additional standard deduction of $1,400 for each dependent with respect to whom the taxpayer is allowed a personal exemption under present law. The increased basic standard deduction and the additional standard deduction for dependents would be adjusted for inflation occurring in future years.

Additional limitation on itemized deductions

The bill would reduce the amount of itemized deductions that are otherwise allowable for a taxable year by 10 percent. This limitation on itemized deductions would be in addition to the limitations under present law.

Effective Date

The bill would apply to taxable years beginning after December 31, 1991.

6. H.R. 3228, "Middle Class Tax Relief Act of 1991" (Ms. DeLauro, Messrs. Bonior, Gejdenson, and Frank, Ms. Pelosi, Messrs. Swett, Jefferson, Johnson of South Dakota, and Abercrombie)

a. personal exemption

Present Law

Personal exemption amount

Taxpayers are allowed a personal exemption for themselves (and a spouse, in the case of a joint return) and for each dependent of the taxpayer. The exemption is structured as a deduction in determining taxable income. The level of the personal exemption was set at $2,000 for taxable years beginning in 1989 and has been indexed for inflation in subsequent years. For taxable years beginning in 1991, the personal exemption is $2,150.

Personal exemption phaseout

Under present law, the deduction for the personal exemptions claimed by a taxpayer is phased out for taxpayers with adjusted gross income (AGI) above a threshold amount. For each $2,500 (or fraction thereof) of AGI above the threshold, the deduction for personal exemptions is reduced by 2 percent. For 1991, the threshold is $150,000 for married individuals filing joint returns, $125,000 for unmarried individuals filing as head of household, and $100,000 for unmarried individuals filing single returns. These threshold figures are to be adjusted for inflation for taxable years after 1991. This phase-out provision is effective for taxable years beginning after December 31, 1990, and before January 1, 1996.

Explanation of Provision

In addition to the personal exemption amount allowed under present law, the bill would allow low-income and certain middle-income taxpayers an additional exemption amount of $1,000 (indexed for inflation) for themselves (and a spouse, in the case of a joint return) and for each dependent. The $1,000 additional exemption amount gradually would be phased out for taxpayers with AGI in the following ranges: $47,000 to $102,000 for married individuals filing joint returns; $37,000 to $87,300 for individuals filing as head of household; $28,000 to $61,000 for unmarried individuals filing single returns; and $23,500 to $51,000 for married individuals filing separate returns. The dollar amounts for the phase-out ranges would be adjusted for inflation for taxable years beginning after 1992.

Effective Date

The provision would apply to taxable years beginning after 1991.

b. Individual tax rates

Present Law

For 1991, the individual income tax rate schedules are—

If taxable income is	Then income tax equals
Single individuals	
$0–$20,350	15 percent of taxable income over $20,350.
$20,350–$49,300	$3,052.50 plus 28% of the amount over $20,350.
Over $49,300	$11,158.50 plus 31% of the amount over $49,300.
Heads of households	
$0–$27,300	15 percent of taxable income.
$27,300–$70,450	$4,095 plus %28 of the amount over $27,300.
Over $70,450	$16,177 plus 31% of the amount over $70,450.
Married individuals filing joint returns	
$0–$34,000	15 percent of taxable income.
$34,000–$82,150	$5,100 plus 28% of the amount over $34,000.
Over $82,150	$18,582 plus 31% of the amount over $82,150.

Explanation of Provisions

Increased individual income tax rates

The bill would provide for a new 36-percent rate to apply to taxable incomes of individuals in excess of—

Single individuals	$70,000
Heads of household	85,000
Married individuals filing joint returns and certain surviving spouses	100,000
Married individuals filing separate returns	50,000

These threshold amounts for the new 36-percent rate bracket are expressed at 1990 levels and would be adjusted for inflation to 1992 levels. For taxable years after 1992, further inflation adjustments would be made.

Surtax

A 15-percent surtax would apply to tax attributable to an individual's taxable income in excess of $225,000.

Effective Date

The provisions would apply to taxable years beginning after 1991.

c. Alternative minimum tax

Present Law

An individual taxpayer is subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent and is applied to the taxpayer's alternative minimum taxable income (generally computed by adding preference items to the taxpayer's regular taxable income).

Explanation of Provision

Increase in individual alternative minimum tax rate

Under the bill, the individual alternative minimum tax rate would be increased from 24 percent to 27 percent.

Surtax on individual alternative minimum tax

The bill would impose a 2.5-percent surtax on the amount of alternative minimum tax attributable to an individual's alternative minimum taxable income in excess of $225,000.

Effective Date

The provision would apply to taxable years beginning after 1991.

d. Corporate income tax rates

Present Law

For 1991, the corporate income tax rate schedule is—

If taxable income is	Then income tax equals
$0–$50,000	15 percent of taxable income.
$50,000–$75,000	$7,500 plus 25% of the amount over $50,000.
$75,000–$100,000	$13,750 plus 34% of the amount over $75,000.
$100,000–$335,000	$22,250 plus 39% of the amount over $100,000.
Over $335,000	34 percent of taxable income.

Explanation of Provision

The bill would increase the top corporate income tax rate from 34 percent to 36 percent.

Effective Date

The provision would apply to taxable years beginning after 1991.

C. Capital Gains and Losses; Passive Losses; Investment Incentives

1. H.R. 246, Indexing of Capital Assets (Mr. Archer and others)

Present Law

The amount taken into account under present law in computing gain or loss from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Explanation of Provision

In general

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

Indexed assets

The bill generally would provide for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock and certain foreign stock.[15]

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1991) (the "applicable inflation ratio"). The applicable inflation ratio would not be taken into account unless it is greater than one. In addition, it would be rounded to the nearest one-tenth of one percent. The indexed basis would be the adjusted basis of the asset, multiplied by the applicable inflation ratio.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset would not be taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion would be disregarded in determining the inflation ratio applicable to the disposition of the common stock. In addition, an asset would not be treated as an indexed asset for any

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[15] Stock in a foreign corporation that is listed on a domestic exchange generally would be treated as an indexed asset.

short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

To the extent that an ordinary loss would be created or increased by the provision, the taxpayer would be treated as having a long-term capital loss in an amount equal to the amount of the ordinary loss.

The indexing adjustment generally would not apply to dispositions between related parties. In addition, if the principal purpose of a transfer is to increase an indexing adjustment, the adjustment may be disallowed.

The indexing adjustment would apply for purposes of determining earnings and profits.

Special entities

In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs) and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio generally would be determined every month. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock would be allowed for that month. Where less than 10 percent of the assets are indexed assets in any month, no indexing would be allowed that month for the stock.

In the case of partnerships, inflation adjustments made at the partnership level would be passed through to the partners.

Effective Date

The provision would apply to dispositions after December 31, 1991.

2. H.R. 248, Capital Gains Exclusion (Mr. Archer)

Present Law

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income, (i.e., 34 percent).

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Explanation of Provision

Under the bill, corporate and noncorporate taxpayers would be allowed a deduction equal to 30 percent of their net capital gains for the taxable year.

Effective Date

The provision would apply to taxable years ending after the date of enactment.

3. H.R. 1414, Treatment of Certain Real Estate Activities Under the Limitations on Losses from Passive Activities (Messrs. Andrews, Thomas of California, Archer, Bunning, Matsui, Vander Jagt, Sundquist, Pickle, Jacobs, Chandler, Jenkins, Crane, Shaw, Grandy, Mrs. Johnson of Connecticut, Messrs. Anthony, Moody, Schulze, Rangel, Downey, Cardin, Dorgan, Guarini; and 206 other original cosponsors)

Present Law

Under present law, the passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. Deductions that are suspended under this rule are carried forward and treated as deductions from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate, and rental activities. A rental activity is treated as a passive activity, regardless of the level of the taxpayer's participation. (A special rules permits the deduction of up to $25,000 of losses from certain rental real estate activities, even though they are considered passive, for taxpayers with adjusted gross incomes of $100,000 or less. This deduction is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000.)

Explanation of Provision

The bill would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of individual and corporate taxpayers "engaged in the real property business". Rental real property activities would be treated the same as nonrental activities, for purposes of determining what is an activity and whether an activity is passive. Under the bill, the taxpayer's material participation in a rental real property activity (or aggregated real property activities) would determine whether losses and credits therefrom are passive and are subject to the limitation of the passive loss rule. Rental activities involving property other than real property would continue to be treated as passive as under present law, regardless of whether the taxpayer materially participates in them.

The bill would provide that a individual is engaged in the real property business if the taxpayer spends at least 50 percent of his working time and more than 500 hours a year in real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, brokerage, appraisal or finance operations. Whether a corporation is engaged in the real property business is determined by the involvement of shareholders or employees in the real property activities of the corporation.

Effective Date

The bill would be effective with respect to taxable years beginning after December 31, 1991. Thus, the provisions of the bill would apply to activities acquired by the taxpayer on or before December 31, 1991, as well as those acquired after that date.

4. H.R. 1445, "Rural Development Investment Zone Act of 1991" (Messrs. Dorgan, Grandy, and others)

a. Targeted geographic areas

Present Law

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, the provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas. Similarly, for purposes of the low-income housing credit, certain geographic areas are designated as high cost or difficult to develop areas for the purpose of increasing the rate of credit applicable to such areas. In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States, as a means to encourage the conduct of trades or businesses within these areas.

Explanation of Provision

Designation of rural development investment zones

The bill would amend the Internal Revenue Code to provide criteria for the designation of rural development investment zones. A rural development investment zone would be any area which was nominated by one or more local governments and the State [16] in which the zone was located, and which was approved by the Secretary of the Treasury after consultation with the Secretaries of Agriculture, Commerce, Labor, and the Administrator of the Small Business Administration. Zone designations generally would remain in effect for 12 years.

Rural development investment zones could be designated only during a 36-month period that would begin after the Secretary of the Treasury promulgates regulations describing the nomination and selection procedures. (Such regulations would be required to be promulgated within four months of enactment of the bill.) No more than 100 rural development investment zones could be designated

[16] The term State would include Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, the Marshall Islands, Micronesia, Palau, and any other possession of the United States.

under this provision, and no more than 40 zones could be designated during the first 12 months following enactment of the bill.

Area and eligibility requirements

An area could be designated as a rural development investment zone, only if the area met requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. A description of these requirements follows:

(1) The area would be required to be (a) within a local government jurisdiction or jurisdictions that are not central cities of a metropolitan statistical area and that have a population of less than 50,000, (b) outside of a metropolitan statistical area, or (c) determined by the Secretary of Treasury (after consultation with the Secretary of Agriculture) to be rural.

(2) The area does not exceed 10,000 square miles, consists of areas within not more than four contiguous counties, consists of not more than three noncontiguous parcels, and is located entirely within one State.

(3) The most recent census would be required to show that the area's population was at least 1,000.

(4) The nominating governments would be required to certify that the area was one of pervasive poverty, unemployment, and general distress. In addition, the area would be required to meet at least two of the following criteria: (a) the unemployment rate is at least 1.5 times the national unemployment rate, (b) the poverty rate is at least 20 percent for not less than 90 percent of the population census tracts in the area, (c) the amount of wages attributable to employment in the area is not more than 95 percent of such wages during the fifth preceding calendar year, and (d) the population of the area decreased by at least 10 percent between 1980 and 1990.

Required State and local government commitments

No area could be designated as a rural development investment zone unless the local government and the State in which the area was located agreed to follow a specified course of action designed to reduce the various burdens borne by employers or employees in the area.

This course of action could be implemented by the State and local governments and private nongovernmental entities, and could be funded from the proceeds of any Federal program. The course of action could include, but would not be limited to: (1) a reduction of tax rates or fees applying within the rural development investment zone; (2) an increase in the level or efficiency of local services within the rural development investment zone; (3) elimination, reduction, or simplification of governmental requirements applying within the zone; (4) program involvement by private entities, organizations, neighborhood associations and community groups, particularly those within the nominated area (including a commitment from these private entities to provide technical, financial or other assistance to, and jobs or job training for, employers, employees and residents of the area); and (5) mechanisms to increase the equity ownership of residents and employees within their rural development investment zone.

Priority of designation

In designating nominated areas, the Secretary of the Treasury would be required to give special preference to those nominated areas for which the strongest and highest quality contributions to a course of action (as described above) had been promised by the nominating governments, taking into account their fiscal ability to provide tax relief. The Secretary also would be required to give preference to nominated areas with the following characteristics: (1) most effective and enforceable guarantees provided by nominating State and local governments that proposed courses of action actually would be carried out for the duration of the designation; (2) high levels of poverty, unemployment and general distress, particularly areas near concentrations of disadvantaged workers or long-term unemployed individuals for whom employment would be a strong likelihood if the area were designated a rural development investment zone; (3) zone size and location that would primarily stimulate new economic activity and minimize unnecessary Federal tax losses; (4) most substantial commitments by private entities of additional resources and contributions, including creation of new or expanded business activities; and (5) nominated zones which best exhibit such other factors that would be consistent with the program's intent and would be important in minimizing unnecessary loss of Federal tax revenues.

Evaluation and reporting requirements

The Secretary would be required to prepare and submit to Congress a report on the effects of designating qualifying areas as rural development investment zones in accomplishing the purposes of the legislation not later than the close of the third calendar year after the year in which areas are first designated as rural development investment zones. Subsequent reports would be required at three-year intervals.

b. Wage tax credit

Present Law

Under present law, the income tax liability of an employer does not vary based on where an employee performs services on behalf of the employer. The targeted jobs tax credit under present law, however, provides an income tax credit to employers for a portion of the wages paid to certain employees, who generally are either economically disadvantaged or participating in a specific education or rehabilitation program. The credit generally is equal to 40 percent of the first $6,000 (or, in the case of a qualified summer youth employee, $3,000) of qualified first-year wages paid to a member of a targeted group. The employer's deduction for wages must be reduced by the amount of the credit claimed.

Explanation of Provision

The bill would provide a 10-percent tax credit for employers in designated rural development investment zones for certain wages paid to qualified employees. Only the amount of qualified wages paid by an employer in designated rural development investment zones during a taxable year which exceeds the qualified wages paid during the 12-month period that preceded the date on which the rural development investment zone was designated would qualify for the credit. In no event, however, would qualified wages with respect to a qualified employee exceed an amount equal to 2.5 times the amount of wages subject to Federal unemployment (FUTA) tax (currently $7,000). Qualified wages for purposes of this credit generally would constitute the definition of wages currently applicable for FUTA tax purposes, with certain adjustments. One such modification would be the exclusion from the wage base of any Federally funded payments the employer received or accrued for on-the-job training. Special rules also would be provided for agricultural and railway labor.

For purposes of the credit, an individual would be required to satisfy a two-part test to become a qualified employee. The first part of the test would require that at least 90 percent of the services of the employee during the taxable year be directly related to the conduct of the employer's trade or business which was located in the rural development investment zone. The second part of the test would require that the employee perform at least 50 percent of the services during the taxable year in the rural development investment zone.

The rate of credit would be reduced from 10 percent to 7.5 percent beginning in the taxable year which includes the date which is 21 years after the area was designated as a rural development investment zone.[17] The rate of credit would be further reduced to 5 percent in the first succeeding year, 2.5 percent in the second year, and zero thereafter.

Effective Date

The wage tax credit would be effective for taxable years beginning after December 31, 1991.

c. Investment tax credit

Present Law

An income tax credit is allowed under present law for certain expenditures incurred in rehabilitating certified historic structures and certain nonresidential buildings that were originally placed in service before 1936. In addition, under present law, an income tax credit is allowed in annual installments over 10 years for certain expenditures incurred in substantially rehabilitating or constructing qualifying low-income rental housing.

Before 1986, a 10-percent investment tax credit was allowed for the cost of eligible tangible personal property that was used in a trade or business or for the production of income. The basis of the property was reduced by one-half of the amount of the credit. The investment tax credit was not allowed with respect to real property.

[17] This appears to be a drafting error, since zone designations would remain in effect for up to 12 years. The intent appears to be that the rate of credit would be phased down during the last four years before an area ceases to be a rural development investment zone.

Explanation of Provision

The bill would provide a 10-percent credit for the taxpayer's basis in new rural development investment zone construction property placed in service during a taxable year in which the zone is so designated. New rural development investment zone construction property would consist of depreciable real property located in a rural development investment zone and used by the taxpayer predominantly in the active conduct of a trade or business within the zone. If acquired by the taxpayer, the first use of the property must commence with the taxpayer. Otherwise the construction, reconstruction, or rehabilitation of the property by the taxpayer must be completed during the period of zone designation. For purposes of this credit, the ownership of rental real estate would constitute an active trade or business.

As with the wage tax credit provided for by the bill, the rate of credit would be reduced from 10 percent to 7.5 percent (and further reduced to 5 percent and 2.5 percent) during the last several years that designation of an area as a rural development investment zone remains in effect.

Effective Date

The investment tax credit would apply to property placed in service in periods after December 31, 1990, under rules similar to prior-law section 48(m).

d. Nontax provisions

Present Law

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on goods imported into a foreign trade zone until the time that the goods leave the foreign trade zone for shipment to other areas of the United States.

Regulatory flexibility

Under present law, Federal government agencies must follow certain procedures in promulgating regulations that are designed to ease the regulatory burden on small businesses, small nonprofit organizations, and small governmental jurisdictions.

Explanation of Provisions

Foreign trade zones

The bill would require the Foreign Trade Zone Board to expedite on a priority basis the processing and approval of any application involving the establishment of a foreign trade zone within a rural development investment zone. The Treasury Department would be required to give the same urgent consideration to an application for establishment of a port of entry (necessary to permit the establishment of a foreign trade zone within a rural development investment zone).

Regulatory flexibility

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified rural development investment zone business, any government designating an area as an rural development investment zone to the extent any regulatory rule would affect carrying out projects within the zone, and any not-for-profit enterprise operating within such a zone.

Responsibilities of Federal agencies

The bill would require Federal agencies to provide special assistance to rural development investment zones to the extent permitted by law. Such assistance could include (but would not be limited to) expedited processing, priority funding, program set-asides, and the provision of technical assistance.

Effective Date

The nontax provisions generally would be effective upon enactment.

5. H.R. 1721, "Capital Gains Tax Fairness Act of 1991" (Messrs. Dorgan and Johnson of South Dakota)

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of certain depreciation, depletion, etc. recapture) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Individuals who have attained the age of 55 are permitted a one-time exclusion from taxable income of up to $125,000 of gain from the disposition of a principal residence.

Depreciation recapture

In general, gain on the sale or other disposition of section 1245 property (depreciable personal property) is taxed as ordinary income to the extent of all previous depreciation or amortization allowances with respect to the property. Gain on the sale or other disposition of section 1250 property (depreciable real property) is taxed as ordinary income to the extent of the excess of accelerated depreciation allowances over the depreciation allowances that would have been available under the straight-line method.

Explanation of Provisions

Lifetime capital gains deduction

The bill would provide individuals aged 25 or older with a deduction equal to 50 percent of their capital gains, up to a lifetime cap of $200,000 of gain. Married couples filing joint returns would be subject to the same $200,000 cap. The deduction would be in addition to the present-law one-time $125,000 exclusion of gain from the sale of a principal residence by an individual aged 55 or older.

Assets eligible for the lifetime capital gains deduction would be capital assets held for more than one year, except collectibles and publicly traded assets (such as stock traded on a stock exchange).

Annual capital gains deduction

In addition to the lifetime capital gains deduction, the bill would provide individuals with a deduction of up to $1,000 of capital gains each year. The deduction would not be available to any individual who may be claimed as a dependent by another taxpayer. In addition, the deduction would not be available to an individual whose adjusted gross income exceeds $150,000. The deduction would be phased out for those with incomes between $100,000 and $150,000. Thus, for example, an individual with $125,000 of adjusted gross income in a particular year could exclude up to $500 of capital gains for that year.

Assets eligible for the annual $1,000 capital gains deduction would be capital assets held for more than one year, including publicly traded assets, but not including collectibles. The annual $1,000 capital gains deduction would not count against the lifetime capital gains deduction and cap described above. Thus, an individual whose income is not greater than $100,000 could exclude up to $1,000 of capital gains each year without reducing the $200,000 amount eligible for the lifetime capital gains deduction.

These capital gain deductions would not apply for purposes of computing alternative minimum taxable income.

Depreciation recapture

The bill also provides that gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property (as opposed to recapturing only the excess of accelerated depreciation over straight-line depreciation, as under present law).

Effective Date

Both the lifetime capital gains deduction and the annual $1,000 capital gains deduction would apply to taxable years ending on or after April 11, 1991. The depreciation recapture provision would apply to dispositions of assets on or after April 11, 1991.

6. H.R. 2646, "The Productive Investment Incentive Act" (Mrs. Johnson, and Messrs. Guarini, Shays, Sharp, and Rhodes)

Present Law

In lieu of depreciation deductions, a taxpayer may elect to expense and deduct up to $10,000 of the cost of qualifying property placed in service for the taxable year (sec. 179). For this purpose, qualifying property generally is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $10,000 amount is reduced by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

Explanation of Provision

The bill would increase the amount eligible to be expensed and deducted to $250,000 in the case of otherwise qualifying property that is for use as an integral part of manufacturing, production, or extraction. In addition, the $200,000 phase-out amount of present law would be increased to $1 million for such property.

In addition, the bill would provide that amounts allowed as a deduction under section 179 would not be treated as an adjustment for purposes of the alternative minimum tax.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1990.

7. H.R. 2873, "Economic Growth and Venture Capital Act of 1991" (Mr. Edwards of Oklahoma)

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income (i.e., 34 percent).

Capital losses are deductible generally only to the extent of capital gains, although individual taxpayers may deduct up to an additional $3,000 of capital losses against ordinary income in any year

($1,500 in the case of a married individual filing a separate return). Individuals may carry over capital losses in excess of this limit to future years indefinitely.

The Tax Reform Act of 1986 repealed a provision allowing a non-corporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Alternative minimum tax

Taxpayers are subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent (20 percent in the case of corporations) and is applied to the taxpayer's alternative minimum taxable income (generally computed by making adjustments and adding preference items to the taxpayer's regular taxable income).

Indexing

The amount taken into account under present law in computing gain or loss from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Explanation of Provisions

Capital gains

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent.

The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill. The adjustment would equal the percentage by which the GNP deflator for the last calendar quarter of the preceding calendar year exceeds the GNP deflator for the last calendar quarter of 1989.

Indexing

In general

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

Indexed assets

The bill generally would provide for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock.[18]

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1990) (the "applicable inflation ratio"). The applicable inflation ratio would not be taken into account unless it is greater than one. In addition, it would be rounded to the nearest one-tenth of one percent. The indexed basis would be the adjusted basis of the asset, multiplied by the applicable inflation ratio.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset would not be taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion would be disregarded in determining the inflation ratio applicable to the disposition of the common stock. In addition, an asset would not be treated as an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

To the extent that an ordinary loss would be created or increased by the provision, the taxpayer would be treated as having a long-term capital loss in an amount equal to the amount of the ordinary loss.

The indexing adjustment generally would not apply to dispositions between related parties. In addition, if the principal purpose of a transfer is to increase an indexing adjustment or a depreciation deduction, the adjustment may be disallowed.

The indexing adjustment would apply for purposes of determining earnings and profits.

Special entities

In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs) and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio generally would be determined every month. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock would be allowed for that month. Where less than 10 percent of the assets are indexed assets in any month, no indexing would be allowed that month for the stock.

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[18] Stock in a foreign corporation that is listed on a domestic exchange generally would be treated as an indexed asset.

In the case of partnerships and S corporations, inflation adjustments made at the partnership and S corporation levels would be passed through to the partners and shareholders.

Effective Date

The provisions would apply to tax years beginning after December 31, 1990.

8. H.R. 3514, Reduction in Capital Gains Rate and Indexing of Capital Assets (Mr. Crane)

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income (i.e., 34 percent).

Capital losses are deductible generally only to the extent of capital gains, although individual taxpayers may deduct up to an additional $3,000 of capital losses against ordinary income in any year ($1,500 in the case of a married individual filing a separate return). Individuals may carry over capital losses in excess of this limit to future years indefinitely.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Alternative minimum tax

Taxpayers are subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent (20 percent in the case of corporations) and is applied to the taxpayer's alternative minimum taxable income (generally computed by making adjustments and adding preference items to the taxpayer's regular taxable income).

Indexing

The amount taken into account under present law in computing gain or loss from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis reflects his actual cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflationary increases in the value of the asset.

Explanation of Provisions

Capital gains

Under the bill, a maximum rate of 15 percent would apply to the net capital gain recognized by individuals and corporations (7.5 percent in the case of individuals in the 15-percent bracket). In addition, the AMT rate on net capital gain would be reduced to 15 percent.

The dollar limitation on the annual use of capital losses by individuals would be indexed for inflation under the bill. The adjustment would equal the percentage by which the GNP deflator for the last calendar quarter of the preceding calendar year exceeds the GNP deflator for the last calendar quarter of 1990.

Indexing

In general

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon sale or other disposition. Assets eligible for the inflation adjustment generally would include corporate stock and tangible property which are capital assets or property used in a trade or business. The adjustment would apply only to assets held more than one year. The deduction for depreciation, depletion and amortization would be determined without regard to the inflation adjustment.

Indexed assets

The bill generally would provide for the indexing of corporate stock and tangible personal property and real property which are capital assets or property used in a trade or business. Specifically excluded from the definition of indexed assets would be creditor's interests, options, net lease property, certain preferred stock, stock in S corporations and personal holding companies, and certain foreign stock.[19]

Computation of inflation adjustment

The inflation adjustment under the bill would be computed by dividing the gross national product ("GNP") deflator in the calendar quarter in which the disposition occurs by the GNP deflator for the calendar quarter in which the asset was acquired by the taxpayer (or, if later, the calendar quarter ending December 31, 1991) (the "applicable inflation ratio"). The applicable inflation ratio would not be taken into account unless it is greater than one. In addition, it would be rounded to the nearest one-tenth of one percent. The indexed basis would be the adjusted basis of the asset, multiplied by the applicable inflation ratio.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset would not be taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion would be disregarded in determining the

[19] Stock in a foreign corporation that is listed on a domestic exchange generally would be treated as an indexed asset.

inflation ratio applicable to the disposition of the common stock. In addition, an asset would not be treated as an indexed asset for any short sale period during which the taxpayer or the taxpayer's spouse sells short property identical to the asset.

To the extent that an ordinary loss would be created or increased by the provision, the taxpayer would be treated as having a long-term capital loss in an amount equal to the amount of the ordinary loss.

The indexing adjustment generally would not apply to dispositions between related parties. In addition, if the principal purpose of a transfer is to increase an indexing adjustment or a depreciation deduction, the adjustment may be disallowed.

The indexing adjustment would apply for purposes of determining earnings and profits.

Special entities

In the case of stock in regulated investment companies (RICs) and real estate investment trusts (REITs) and interests in common trust funds, partial indexing would be provided by the bill based on the ratio of the value of indexed assets held by the entity to the value of all its assets. This ratio generally would be determined every month. Where the ratio of indexed assets to total assets exceeds 90 percent in any month, full indexing of the stock would be allowed for that month. Where less than 10 percent of the assets are indexed assets in any month, no indexing would be allowed that month for the stock.

In the case of partnerships and S corporations, inflation adjustments made at the partnership and S corporation levels would be passed through to the partners and shareholders.

Effective Date

The provisions generally would apply to sales or exchanges occurring after December 31, 1991. The provision that provides for the indexing of the limitation on capital losses would apply to tax years beginning after December 31, 1991.

9. H.R. 3652, Treatment of Certain Real Estate Activities Under the Passive Loss Rules; Capital Gains Exclusion for Individuals Based on the period the Asset is Held (Mr. Shaw)

a. Passive loss rules

Present Law

Under present law, the passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. Deductions that are suspended under this rule are carried forward and treated as deductions from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate, and rental activities. A rental activity is treated as a passive activity, regardless of the level of the taxpayer's participation. (A special rules permits the deduction of up to $25,000 of losses from certain rental real estate activities, even though they are considered passive, for taxpayers with adjusted gross incomes of $100,000 or less. This deduction is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000.)

Explanation of Provision

The bill would provide that the passive loss limitation does not apply to losses and credits from certain rental real estate activities of individual and corporate taxpayers "engaged in the real property business". Rental real property activities would be treated the same as nonrental activities, for purposes of determining what is an activity and whether an activity is passive. Under the bill, the taxpayer's material participation in a rental real property activity (or aggregated real property activities) would determine whether losses and credits therefrom are passive and are subject to the limitation of the passive loss rule. Rental activities involving property other than real property would continue to be treated as passive as under present law, regardless of whether the taxpayer materially participates in them.

The bill would provide that a taxpayer is engaged in the real property business if the taxpayer spends at least 50 percent of his working time and more than 500 hours a year in real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, brokerage, appraisal or finance operations. Whether a corporation is engaged in the real property business is determined by the involvement of shareholders or employees in the real property activities of the corporation.

Effective Date

The bill would be effective with respect to taxable years beginning after December 31, 1991. Thus, the provisions of the bill would apply to activities acquired by the taxpayer on or before December 31, 1991, as well as those acquired after that date.

b. Capital gains exclusion for individuals

Present Law

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of certain depreciation, depletion, etc. recapture) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Explanation of Provision

The bill would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held three years or more would qualify for a 30-percent exclusion; assets held at least two years but less than three years would qualify for a 20-percent exclusion; and assets held at least one year but less than two years would qualify for a 10-percent exclusion.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded.

The capital gains exclusion would be a preference for purposes of the alternative minimum tax.

Effective Date

The bill would apply to sales and exchanges after September 30, 1991. For the portion of 1991 to which the proposal would apply, a 30-percent exclusion would apply for all assets held one year or more. For 1992, the exclusion would be 20 percent for assets held between one and two years and 30 percent for assets held at least two years.

10. H.R. 3741, "Enterprise Capital Formation Act of 1991" (Messrs. Matsui, Moody, Gradison, Markey, Hoagland, Pickle, Vander Jagt, Guarini, McGrath, Anthony, Chandler, Andrews of Texas, Mrs. Johnson of Connecticut, Mr. Bunning, and others)

Present Law

Sale or exchange of capital assets

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. For corporations, the maximum rate on net capital gain is the same as the maximum rate on ordinary income, i.e. (34 percent).

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Also under prior law, corporations were subject to an alternative tax of 28 percent on net capital gain. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Section 1244 stock

A loss recognized by an individual on section 1244 stock which otherwise would be treated as a capital loss is treated as an ordinary loss, subject to a limit of $50,000 for any taxable year ($100,000 in the case of a joint return). Section 1244 stock is stock in a domestic corporation if the corporation is a small business corporation, the stock is issued for money or other property (other than stock and securities), and the corporation derived more than 50 percent of its aggregate gross receipts during its past five taxable years from sources other than royalties, rents, dividends, interest, annuities, and sales or exchanges of stocks or securities. A corporation is treated as a small business corporation if the aggregate amount of money and other property received for stock, as a contribution to capital and as paid-in surplus, does not exceed $1 million.

Explanation of Provisions

Qualified small business net capital gain

The bill would provide taxpayers with a capital gain deduction with respect to dispositions of qualified small business stock. Taxpayers who have held qualified small business stock for more than five years would be allowed a deduction equal to 50 percent of their qualified small business net capital gain. A maximum rate of 14 percent would apply to such gains recognized by individuals; a maximum 17 percent rate would apply for corporations.

Qualified small business stock would be stock issued after December 31, 1991,[20] acquired at original issue for money or as compensation for services. At the time of issue, the amount of money, the adjusted basis of property and the value of services received by the corporation for stock as a contribution to capital and as paid-in surplus, plus the accumulated earnings and profits of the corporation, could not exceed $100 million (as indexed for inflation). In addition, the corporation must conduct an active business and use substantially all its assets in an active business during the 5-year period commencing with the acquisition of the stock.[21] Certain start-up activities, activities resulting in research and experimental expenditures, computer software royalties and working capital would count towards the active business test. However, a corporation would not satisfy the active business test if more than 10 percent of its assets consists of portfolio stock investments or real property not used in an active trade or business.

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[20] Anti-abuse rules would be provided to prevent corporations from redeeming stock issued before the effective date and reissuing stock after the effective date in order to qualify for the capital gains deduction.

[21] A corporation that owns at least 50 percent of a subsidiary would be deemed to own its ratable share of the subsidiary's assets and to conduct its ratable share of the subsidiary's activities.

Stock acquired by the taxpayer through the exercise of certain options or warrants, or through the conversion of convertible debt, would be treated as acquired at original issue, and as having been held during the period such option, warrant or debt was held.

If property (other than money or stock) is transferred to a corporation for stock, the basis of the stock received would be treated as equal to the fair market value of the property exchanged. Thus, for example, only gains that accrue subsequent to the transfer would be eligible for the capital gains deduction.

The qualified small business capital gain deduction would be treated as a preference item under the alternative minimum tax.

Seed capital gain deduction

In addition to a deduction for qualified small business net capital gain, the bill also would provide taxpayers with a seed capital gain deduction with respect to dispositions of qualified small business stock in corporations with paid-in capital and surplus not in excess of $5 million (as indexed for inflation). The deduction for seed capital gain would be on a sliding scale, depending on holding period: 50 percent for more than five years to six years, 60 percent for more than six years to seven years, 70 percent for more than seven years to eight years, 80 percent for more than eight years to nine years, 90 percent for more than nine years to 10 years, and 100 percent for more than 10 years.

A maximum 14 percent rate would apply to seed capital gains recognized by individuals; the maximum rate would be 17 percent for corporations.

The seed capital gain deduction would not be treated as a preference item under the alternative minimum tax.

Section 1244 stock

The amount of money and other property that a small business corporation can receive for stock as a contribution to capital and as paid-in surplus would be increased from $1 million to $5 million, and is adjusted for inflation.

Effective Date

The bill would apply to stock issued after December 31, 1991. If a taxpayer holds appreciated stock that would have been treated as qualified small business stock at the time it was issued had these rules been in place, the taxpayer may elect to recognize all accrued gain with respect to such stock. In such event, any subsequent gains would be eligible for the qualified small business capital gain deduction or the seed capital gain deduction. The holding period for such stock would begin on the date the gain is recognized.

11. H.R. 3810, "The Investment Incentive and Recovery Act of 1991" (Messrs. Guarini and Levin)

Present Law

Taxpayers are allowed to offset all or a portion of their tax liabilities with certain tax credits, including the general business credit. Special rules apply to the application of the general business credit. These rules include: (1) the taxable income limitation of section 38(c); (2) the carryover rules of section 39; (3) the at-risk rules of section 49; (4) the recapture rules of section 50(a) (adjusted in the case of 3-year property); (5) the disallowance rules of section 50(b); and (6) the basis adjustment rules of section 50(c).

One component of the general business credit is the investment tax credit. Under present law, the investment tax credit is a 10-percent credit available for certain rehabilitation expenditures, certain reforestation expenditures, and the acquisition of certain energy property. Prior to the enactment of the Tax Reform Act of 1986, the investment tax credit generally was available for up to 10 percent of a taxpayer's investment in certain tangible depreciable property (generally, not including buildings or structures. The Tax Reform Act of 1986 repealed the investment tax credit for most investments in qualified property.

Explanation of Provision

The bill would provide a 7.5-percent income tax credit for increasing the amount invested in new manufacturing and other productive equipment.

Under the bill, the amount of the credit for any taxable year would equal 7.5 percent of the excess (if any) of (1) the aggregate bases of qualified manufacturing and productive equipment properties placed in service during such year, over (2) the base amount for such taxable year. The base amount generally would be determined by multiplying the average gross receipts of the taxpayer for the preceding 4 taxable years by a ratio the numerator of which is the aggregate bases of qualified manufacturing and productive equipment properties placed in service during taxable years beginning after 1986 and before 1991 and the denominator of which is the aggregate gross receipts of the taxpayer for taxable years beginning after 1986 and before 1991. In no event shall the base amount be less than 50 percent of the amount of the aggregate bases of qualified manufacturing and productive equipment properties placed in service during such year.

The term "qualified manufacturing and productive equipment property" would be defined as any property that (1) is used as an integral part of the manufacture or production of tangible personal property; (2) is tangible property to which section 168 applies; and (3) is section 1245 property (thereby excluding buildings and the structural components of a building). In addition, in order for property to be considered qualified manufacturing and productive equipment property, the construction, reconstruction, or erection of the property must be completed by the taxpayer, or, in the case of property acquired by the taxpayer, the original use of the property must commence with the taxpayer. Under a special rule, computer software that is used to control or monitor a manufacturing or production process is treated as qualified manufacturing and productive equipment property if a depreciation or amortization deduction is allowable with respect to the software.

Property qualifying for the energy credit or the rehabilitation credit of present law would not be taken into account for purposes of the new credit unless the taxpayer elects otherwise.

The new credit would be a component of the investment tax credit under present law and, as such, the credit generally would be subject to special rules applicable to the general business credit. However, the credit would be allowed to offset 100 percent of the regular tax and alternative minimum tax liabilities of the taxpayer.

Effective Date

The bill would apply to property acquired by a taxpayer after December 31, 1991, and property the construction, reconstruction, or erection of which is completed by a taxpayer after December 31, 1991, but only to the extent of the basis that is attributable to construction, reconstruction, or erection after December 31, 1991.

12. H.R. 3875, "Middle Income Tax Relief Act of 1991" (Messrs. Donnelly, Neal, and Mavroules)

a. Sale or exchange of capital assets by individuals

Present Law

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, a special rule treats net gain (in excess of recapture of certain depreciation, depletion, etc.) from the sale, exchange, or involuntary conversion of depreciable property or land held for more than one year and used in a trade or business as gain from the sale or exchange of a capital asset. This special rule also applies to certain transactions involving timber, coal, domestic iron ore, livestock and unharvested crops.

The Tax Reform Act of 1986 repealed a provision allowing a noncorporate taxpayer a deduction for 60 percent of its net capital gain for the taxable year. Net capital gain is the excess of net long-term capital gain for the taxable year over net short-term capital loss for that year. Gain or loss from the sale or exchange of a capital asset is treated as long term if the asset is held for more than one year.

Individuals who have attained the age of 55 are permitted a one-time exclusion from taxable income of up to $125,000 of gain from the disposition of a principal residence.

Explanation of Provision

The bill would provide individuals aged 25 or older with a deduction equal to 50 percent of their capital gains, up to a lifetime cap of $400,000 of gain. This provision is equivalent to an exclusion of $200,000 of gain over an individual's lifetime. The deduction would be in addition to the present-law one-time $125,000 exclusion of gain from the sale of a principal residence by an individual aged 55 or older. Assets eligible for the lifetime capital gains deduction (i.e., "qualified assets") are capital assets held for more than three years, except collectibles (such as works of art).

Under the bill, the amount of gain on the sale or exchange of real property (i.e., property defined in section 1250(c)) that qualifies for the deduction is determined by reference to a basis of the real property that is indexed for inflation (in lieu of the property's adjusted tax basis).

A taxpayer's qualified gain under the bill would be the lesser of the net capital gain on the sale or exchange of a qualified asset for the taxable year, or the net capital gain for the taxable year determined by only taking into account gains and losses from sales and exchanges on or after the date of enactment of the bill.[22] That is, recognition of deferred gain from an asset disposition occurring prior to the bill's enactment date would not give rise to a capital gains deduction. A taxpayer may irrevocably elect for any taxable year not to take into account for purposes of computing the deduction all or any portion of qualified gain for such taxable year.

The capital gains deduction would not be available to any taxpayer whose adjusted gross income exceeds $250,000. The deduction would be phased out ratably for those with incomes between $200,000 and $250,000.[23] For example, an individual who recognizes $100,000 of qualified capital gains in a particular taxable year would be entitled to a maximum allowable deduction under the bill of $50,000. If that individual's adjusted gross income for that year is $230,000, however, he could exclude only $20,000 of capital gains for that year.

The capital gains deduction would not apply with respect to married persons filing separate returns or estates or trusts, or in the case of sales or exchanges of qualifying assets to related persons (within the meaning of sections 267(b) or 707(b)(1)).

The capital gains deduction would not apply for purposes of computing alternative minimum taxable income.

Effective Date

The lifetime capital gains deduction would apply to sales and exchanges of qualified assets occurring after the date of enactment of the bill.

b. Individual income tax rates

Present Law

Regular income tax rates

For 1991, the individual tax rate schedules are—

[22] For this purpose, any carryover of a net capital loss is treated as a loss from a post-enactment date sale or exchange of a qualified asset.

[23] For this purpose, adjusted gross income is determined without taking into account the capital gains deduction.

If taxable income is	Then income tax equals
Single individuals	
$0–$20,350	15 percent of taxable income.
$20,350–$49,300	$3,052.50 plus 28% of the amount over $20,350.
Over $49,300	$11,158.50 plus 31% of the amount over $49,300.
Heads of households.	
$0–$27,300	15 percent of taxable income
$27,300–$70,450	$4,095 plus 28% of the amount over $27,300.
Over $70,450	$16,177 plus 31% of the amount over $70,450.
Married individuals filing joint returns	
$0–$34,000	15 percent of taxable income.
$34,000–$82,150	$5,100 plus 28% of the amount over $34,000.
Over $82,150	$18,582 plus 31% of the amount over $82;150.

Alternative minimum tax

A taxpayer is subject to an alternative minimum tax (AMT) if the amount of that tax exceeds the taxpayer's regular tax liability. The AMT rate is 24 percent for noncorporate taxpayers and is applied to the taxpayer's alternative minimum taxable income (generally computed by making certain adjustments and adding preference items to the taxpayer's regular taxable income).

Explanation of Provisions

Regular Income tax rates

Under the bill, a new 34-percent marginal tax rate would apply to taxable incomes in excess of—

Single individuals	$250,000
Heads of household	250,000
Married individuals filing joint returns and certain surviving spouses	250,000
Married individuals filing separate returns	150,000
Estates and trusts	75,000

Alternative minimum tax

The individual alternative minimum tax rate would be increased to 29 percent.

Effective Date

The increase in income tax rates applicable to taxpayers other than corporations would apply to taxable years beginning after December 31, 1991.

13. H.R. 3945, Recognition of Losses on Sale of a Principal Residence (Mr. Archer)

Present Law

Under present law, a loss on the sale of a personal residence is not a capital loss that can be used to offset capital gain from the sale of a personal residence.

Explanation of Provision

The bill would provide that gains that would be recognized on the sale or exchange of a principal residence of a taxpayer are reduced (but not below zero) by the aggregate of the losses sustained by the taxpayer on the sale or exchange of prior principal residences of the taxpayer that were not previously taken into account. Only losses on sales or exchanges after December 31, 1990, would be taken into account.

Effective Date

The provision would be effective for sales and exchanges after December 31, 1990.

14. H.R. 3979, Income Tax Credit for Payments or Contributions to Centain Cooperative Research Organizations (Mr. Levin)

Present Law

Research credit—general rules

A 20-percent tax credit is allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit will not apply to amounts paid or incurred after December 31, 1991.[24]

A 20-percent tax credit also applies to the *excess* of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research *over* (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

Computation of allowable credit

Except for certain university basic research payments, the credit applies only to the extent that the taxpayer's qualified research expenditures for the taxable year exceed its base amount. The base amount for the current year is computed by multiplying the tax-

[24] H.R. 3909, which was passed by the House of Representatives and Senate on November 27, 1991, would extend the research credit for six months (i.e., for qualified expenditures paid or incurred through June 30, 1992).

payer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years.

If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 to 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenses for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (such as "start-up" firms) are assigned a fixed-base percentage of .03.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

Eligible expenditures

Research expenditures eligible for the credit consist of: (1) "inhouse" expenditures by the taxpayer for research wages and supplies; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf.

The research credit is not available for research to the extent funded by any grant, contract, or otherwise by another person (or government entity).

Relation to deduction

Deductions for qualified research expenditures allowed to a taxpayer under section 174 or any other provision are reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

Orphan drug credit

Under present law, a 50-percent tax credit is allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs, generally referred to as "orphan drugs," for certain rare diseases or conditions. Qualified testing expenses are costs incurred to test an orphan drug after it has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA.

The orphan drug credit applies to qualified expenses incurred through December 31, 1991.[25]

Explanation of Provisions

In general

H.R. 3979 would provide that taxpayers who make qualifying payments or contributions to a qualified cooperative research organization ("research cooperative") would be eligible for an income tax credit of up to 50 percent of the amount of such payments or contributions.

For purposes of the bill, a research cooperative eligible to receive qualifying contributions would be an organization that (1) is regis-

[25] H.R. 3909, which was passed by the House of Representatives and Senate on November 27, 1991, would extend the orphan drug credit for six months (i.e., for qualified expenses incurred through June 30, 1992).

tered with the United States Attorney General and the Federal Trade Commission under the National Cooperative Research Act of 1984, and (2) has five or more members, at least four of which made contributions to the research cooperative in the prior fiscal year equal to at least 20 percent of the amount of contributions made by the nongovernmental contributor who provided the largest amount of support to that cooperative.

Computation of credit

Under the bill, the amount of the credit would equal the taxpayer's qualified cooperative research expenditures incurred during the taxable year multiplied by the applicable credit rate. Qualified cooperative research expenditures would be limited to the lesser of: (a) 100 percent of the current-year qualified expenditures; or (b) the sum of (1) 50 percent of such expenditures for the current year, (2) 30 percent of such expenditures for the first preceding year, plus (3) 20 percent of such expenditures for the second preceding year.

The applicable credit rate would vary for each recipient research cooperative, depending on the funding sources for that cooperative. The applicable credit rate would be equal to the sum of: (1) 25 percent of the cooperative's private source funding ratio (i.e., the ratio that its nongovernmental funding bears to its total gross receipts) for the first preceding year, (2) 15 percent of the cooperative's private funding ratio for the second preceding year, plus (3) 10 percent of the cooperative's private funding ratio for the third preceding taxable year. Thus, if a research cooperative received its funding entirely from private, nongovernmental sources, the applicable percentage rate would be 50 percent.

Research cooperatives would be required to report their applicable credit rate to contributors and the Internal Revenue Service.

Qualified expenditures

Expenditures which would qualify for the credit generally would be cash payments or the fair market value of property or other inkind contributions (including the use of the taxpayer's real property, personal property, intangible property or employees) made to a qualified research cooperative. In the case of property that is licensed or permitted to be used by the research cooperative, the value of the contribution could not exceed the amount of depreciation or amortization otherwise allowable for the property for that year. In the case of contributed services, the value of the contribution could not exceed the amount of salary, benefits, and certain overhead expenses attributable to the contributed services. In any event, the amount of non-cash property or services contributed eligible for the credit could not exceed the amount of cash contributed by the taxpayer to that cooperative during the taxable year.

In the case of contributions made by a taxpayer that are designated or restricted to a specific project, the contributions would be eligible for the credit only to the extent that the taxpayer's project-specific contributions were necessary for the accomplishment of the project objectives and did not exceed one-third of all project-specific contributions from other nongovernmental sources.

Contributions qualifying for the credit would not include any amounts funded by a grant, contract, or otherwise by any governmental entity.

Relationship to other credits and deductions

Amounts qualifying for the credit under the bill would not be eligible for the present-law research or orphan drug credits. Any deductions otherwise allowable for amounts contributed to a research cooperative would be reduced by the amount of the credit provided for by the bill.

Effective Date

The bill would be effective for taxable years beginning after the date of enactment.

D. Individual Retirement Arrangements; Homebuyers' Tax Credit

1. H.R. 519, Penalty-Free Withdrawals From IRAs, Etc. for Purchase of First Home (Mr. Thomas)

Present Law

Distributions from qualified retirement plans, tax-sheltered annuities (sec. 403(b)), and individual retirement arrangements (IRAs) are generally includible in income when received. In addition, amounts distributed prior to age 59½, death, or disability are generally subject to an additional 10-percent income tax unless the distribution is in the form of substantially equal periodic payments over the life (or life expectancy) of the individual or over the joint lives (or life expectancies) of the individual and his or her beneficiary. A qualified cash or deferred arrangement (a sec. 401(k) plan) is a type of tax-qualified plan under which individuals can elect to contribute on a pre-tax basis. Distributions may not be made from a section 401(k) plan prior to death, disability, termination of employment, or attainment of age 59½ unless the distribution is on account of financial hardship.

Explanation of Provision

The bill would permit taxpayers to withdraw up to $10,000 from an IRA, section 401(k) plan, or tax-sheltered annuity for the purchase of a first home without the imposition of income tax or the 10-percent tax on early withdrawals. The $10,000 limit would be phased out for single taxpayers with modified adjusted gross income (AGI) over $30,000, for married taxpayers filing a joint return with modified AGI over $50,000, and for married taxpayers filing a separate return with modified AGI over $25,000. The limit is reduced by $1 for each $2 by which modified AGI exceeds the applicable threshold (or by $2 for each $2 of excess in the case of married taxpayers filing a separate return). In the case of section 401(k) plans and tax-sheltered annuities, the provision would apply only to amounts contributed at the election of the employee (and earnings thereon). For purposes of the provision, distributions from an IRA would be treated as first from nondeductible contributions.

The bill would also waive the 10-percent early withdrawal tax on distributions from IRAs, section 401(k) plans, and tax-sheltered annuities to pay for the first home of a child of the taxpayer. Such distributions would be subject to the same limitations applicable to withdrawals to pay for the first home of the taxpayer (treating the child as the taxpayer).

Effective Date

The bill would apply to distributions made after the date of enactment.

2. H.R. 1406, "Savings and Investment Incentive Act of 1991" (Messrs. Pickle, Thomas, Andrews, Schulze, Mazzoli, and others)

Present Law

Under present law, under certain circumstances, an individual is allowed to deduct contributions (up to the lesser of $2,000 or 100 percent of the individual's compensation or earned income) to an individual retirement arrangement (IRA). The amounts held in an IRA, including earnings on contributions, generally are not included in gross income until withdrawn. Withdrawals prior to attainment of age 59½ are generally subject to an additional 10-percent early withdrawal tax.

The $2,000 deduction limit is phased out over certain adjusted gross income (AGI) thresholds if the individual or the individual's spouse is an active participant in an employer-sponsored retirement plan. An individual may make nondeductible IRA contributions (up to the $2,000 or 100 percent of compensation limit) to the extent the individual is not permitted to make or does not make deductible IRA contributions.

Explanation of Provisions

The bill would adjust the $2,000 deduction limit for IRA contributions for inflation in $500 increments.

The bill would restore the deductibility of IRA contributions for all taxpayers under the rules in effect prior to the Tax Reform Act of 1986 and would index for inflation the limits on contributions to IRAs. In addition, the bill would create a new special IRA to which a taxpayer could make nondeductible contributions. Withdrawals from a special IRA would not be includible in income if attributable to contributions that had been held by the special IRA for at least 5 years. The limits on contributions to deductible IRAs and special IRAs would be coordinated.

The bill would provide that the 10-percent additional income tax on early withdrawals would not apply to withdrawals from an IRA and from elective deferrals under (1) a qualified cash or deferred arrangement (sec. 401(k) plan), (2) a tax-sheltered annuity (sec. 403(b)), or (3) a section 501(c)(18) plan to the extent the amount withdrawn is used for the purchase of a first home, or for certain education expenses. The bill would also extend the exception for certain medical expenses to IRAs.

Effective Date

The provisions of the bill would generally be effective for taxable years beginning after December 31, 1990, except that the new exceptions to the early withdrawal tax would apply to distributions after the date of enactment.

3. H.R. 3739, Tax Credit for the Purchase of a Principal Residence by a First-Time Homebuyer (Mrs. Johnson)

Present Law

There is no credit for first-time homebuyers under present law.

Explanation of Provision

The bill would provide first-time homebuyers a nonrefundable tax credit equal to 5 percent of the purchase price of a principal residence with a maximum credit of $2,000. No credit would be permitted to any individual whose adjusted gross income for the taxable year exceeds $50,000 ($100,000 in the case of a joint return). If two or more people purchase the house for use as their principal residence, then the credit would be split among them (according to regulations) as long as all of the purchasers are first-time homebuyers.

First-time homebuyers are defined as individuals who had no present ownership interest in a principal residence during the 3-year period prior to the acquisition of the property qualifying for the credit. If the individual is married, his or her spouse must also meet the above test in order the individual to be characterized as a "first-time homebuyer."

Properties for which the purchaser's basis is determined by reference to the adjusted basis of the seller or by application of section 1014(a) (relating to property acquired from a decedent) would not be eligible for the credit. The size of the credit would not be indexed for inflation.

Effective Date

The bill would apply to principal residences purchased after the date of enactment. However, to obtain the credit, a taxpayer must (1) enter into a binding contract to acquire the principal residence within 3 months of the date of enactment in cases of residences not constructed by the taxpayer; or (2) occupy the principal residence within 3 months of the date of enactment in cases of residences constructed by the taxpayer.

E. Other Proposals

1. H.R. 710, "Tax-Exempt Bond Simplification Act of 1991" (Messrs. Anthony, Coyne, Guarini, Jacobs, Matsui, Moody, Shaw, and Sundquist)

Present Law

In general

Interest on State and local government bonds generally is excluded from income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units. Present law also excludes the interest on State and local government bonds ("private activity bonds") when a governmental unit incurs debt as a conduit to provide financing for private parties, if the financed activities are specified in the Internal Revenue Code (the "Code"). Tax-exempt bonds may not be issued to finance private activities not specified in the Code.

Private activity bonds are bonds (1) more than 10 percent of the proceeds of which satisfy a private business use and payment test, or (2) more than five percent ($5 million, if less) of the proceeds are used to finance loans to persons other than State or local governmental units. A special restriction limits to no more than five percent the amount of bond proceeds that may be used in a private business use that is unrelated to direct governmental activities also being financed with a bond issue. This five-percent restriction is known as the "unrelated and disproportionate private business use limit."

Interest on the following private activity bonds qualifies for exclusion:

(1) Exempt-facility bonds;
(2) Qualified mortgage and qualified veterans' mortgage bonds;
(3) Qualified small-issue bonds;
(4) Qualified student loan bonds;
(5) Qualified redevelopment bonds; and
(6) Qualified 501(c)(3) bonds.

Exempt-facility bonds are bonds the proceeds of which are used to finance the following: airports, docks and wharves, mass commuting facilities or high-speed intercity rail facilities; water, sewage, solid waste, or hazardous waste disposal facilities; facilities for the local furnishing of electricity or gas; local district heating or cooling facilities; and certain low-income rental housing projects.

Arbitrage restrictions

Issuers of all tax-exempt bonds generally are subject to two sets of restrictions on investment of their bond proceeds.

Yield restriction requirement

In general, tax-exempt bond proceeds may not be invested at a yield materially higher than the bond yield (i.e., only limited arbitrage profits may be earned). Exceptions are provided to this restriction for investments during any of several "temporary periods" pending use of the proceeds (generally prescribed in Treasury

Department regulations). Additional exceptions are provided for bond proceeds invested as part of a reasonably required reserve or replacement fund and for a "minor" portion of the proceeds of a bond issue, both throughout the term of the issue.

Unlike the rebate requirement described below, the yield restriction requirement applies both to investments unrelated to the purpose of the borrowing ("nonpurpose investments") and to investments such as a loan to the ultimate borrower of the bond proceeds in the case of private activity bonds ("purpose investments").

Rebate requirement

Generally, all arbitrage profits earned on nonpurpose investments of bond proceeds during periods when such earnings are permitted (e.g., initial temporary periods pending expenditure of the proceeds) must be rebated to the Federal Government. Permitted arbitrage profits on purpose investments (limited by the yield restriction requirement described above) are not subject to the rebate requirement. Present law includes three principal exceptions to the rebate requirement on nonpurpose arbitrage profits.

Six-month expenditure exception.—First, if all gross proceeds of an issue are spent for the purpose of the borrowing within six months after the bonds are issued, no rebate is required. This exception may be satisfied notwithstanding the presence of a reasonably required reserve or replacement fund if all proceeds other than those invested as part of the reserve fund are so spent and arbitrage profits on the reserve fund (and any bona fide debt service fund subject to rebate) are rebated.

24-month construction bond expenditure exception.—Second, no rebate is required for certain construction bond issues if the available construction proceeds are spent for the purpose of the borrowing at least at specified rates during the 24-month period after the bonds are issued. A construction bond issue is an issue at least 75 percent of the net proceeds of which are to be used to finance construction (as opposed to acquisition) expenses. Construction bonds eligible for this exception include all governmental bonds, qualified 501(c)(3) bonds, and private activity bonds the proceeds of which are used to finance property owned by a governmental unit.

The minimum spending rates are as follows: (1) at least 10 percent spent within six months after the bonds are issued, (2) at least 45 percent spent within 12 months, (3) at least 75 percent spent within 18 months, and (4) 100 percent spent within 24 months. Amounts of reasonable retainage (not exceeding five percent of the available construction proceeds) that remain unspent after 24 months, and which are spent no later than 36 months after issuance do not preclude eligibility for this exception.

Issuers of construction bonds with respect to which these spending requirements are not satisfied may elect to pay a special penalty equal to 1.5 percent of any shortfall in required spending at each six-month interval in lieu of complying with the general rebate requirement. Additionally, these issuers may elect to terminate these 1.5-percent penalties by payment of an additional 3-percent penalty on the earlier of (1) expiration of the initial temporary period when proceeds may be invested without regard to yield or (2) substantial completion of the spending purposes of the borrowing.

The construction bond exception applies to bonds issued after December 19, 1989.

Small-issuer exception.—Bonds other than private activity bonds issued by governmental units having general taxing powers are not subject to the rebate requirement if the governmental unit (and all of its subordinate units) issues $5 million or less in such governmental bonds during a calendar year.

Restrictions on advance refundings

The Code restricts authority to advance refund tax-exempt bonds to bonds other than private activity bonds and to private activity qualified 501(c)(3) bonds. An advance refunding is a refunding where the refunded bonds are not redeemed within 90 days after the refunding bonds are issued. Except for certain bonds originally issued before 1986, each issue of new-money governmental and qualified 501(c)(3) bonds may be advance refunded only one time.

In addition, the Code prohibits the advance refunding of any bond if the transaction involves the use of a "device" to obtain a material financial advantage (based on arbitrage) other than the savings received from lower interest rates on the refunding bonds. The Treasury Department is authorized to identify prohibited devices by regulation.

Tax treatment of financial institutions investing in tax-exempt bonds

Banks and other financial institutions generally are denied a deduction for the portion of their interest expense (e.g., interest paid to depositors) that is attributable to investments in tax-exempt bonds acquired after August 7, 1986. This disallowance is computed using a prorata formula that compares the institution's average adjusted basis in tax-exempt bonds acquired after that date with the average adjusted basis of all assets of the institution.

An exception to this prorata disallowance rule is permitted for governmental bonds and qualified 501(c)(3) bonds issued by or on behalf of governmental units that issue no more than $10 million of such bonds during a calendar year.

Explanation of Provisions

H.R. 710 would make numerous changes to requirements governing issuance of tax-exempt bonds.

Unrelated and disproportionate private business use limit

The bill would repeal the unrelated and disproportionate private business use limit. Allowable private business use of governmental bond proceeds would continue to be restricted by the general private business use and payments test and the private loan bond restriction.

Liberalization of arbitrage restrictions

Elimination of yield restriction requirement in certain cases

The bill would eliminate the present-law arbitrage yield restrictions for all bonds other than advance refunding bonds except where the Treasury Department by regulation identified the yield restriction requirement as existing for a purpose other than preventing the earning of arbitrage profits.

Reduction of arbitrage profits subject to rebate

The bill would permit issuers to retain 10 percent of the arbitrage profits they earn on nonpurpose investments.

Expansion of small-issuer rebate exception

The bill would increase the $5 million annual issuance limit for small issuers whose governmental bonds are not subject to rebate to $25 million, and would expand the exception to apply to governmental bonds issued (1) by governmental units without taxing powers and (2) by "on behalf of" authorities that are not themselves governmental units.

Retroactive relief for certain construction bond issues

The bill would make retroactive the present 24-month expenditure exception to the arbitrage rebate requirement for certain construction bonds. Thus, issuers of such bonds issued after August 15, 1986 (August 31, 1986 for governmental bonds), would be exempt from the rebate requirement on a prospective basis if they satisfied the 24-month expenditure schedule. Additionally, issuers of bonds issued after those dates could elect to comply with the exception's penalty regime on unexpended proceeds in lieu of further rebate.

Identification of prohibited device

The bill would treat as a prohibited device the issuance of advance refunding bonds in conjunction with the investment of existing bond funds (released from bond indenture restrictions) in investment contracts having materially higher and substantially guaranteed yields, if such an investment occurred within 90 days before or after issuance of advance refunding bonds.

Expansion of financial institution small-issuer exception

The bill would increase from $10 million to $25 million the small-issuer exception to the interest expense deduction prorata disallowance rule applicable to banks and other financial institutions.

Effective Dates

Except as otherwise provided, the provisions of the bill would apply to bonds issued after December 31, 1990.

The repeal of the unrelated and disproportionate private business use limit and the reduction in the amount of arbitrage profits required to be rebated would apply to bonds issued after the date of the bill's enactment.

The provision eliminating the arbitrage yield restriction requirement would apply to bonds issued after the effective date of the bond provisions in the Tax Reform Act of 1986, but only with respect to earnings accruing after the date of the bill's enactment.

The retroactive extension of the special rebate exception for construction bonds would be effective on enactment.

The provision identifying a new prohibited device would apply to advance refunding bonds issued after February 26, 1990.

2. H.R. 951, "The Boating Industry Jobs Preservation Act of 1991" (Messrs. Shaw, Vander Jagt, McGrath, Petri, Smith of Florida, Henry, Saxton, Machtley, Abercrombie, and Bonior)

Present Law

Luxury excise tax on boats

Present law imposes a 10-percent excise tax on the portion of the retail price of pleasure boats above $100,000. Boats that are used exclusively (other than a de minimis amount) in a trade or business (except for entertainment or recreation purposes, including the trade or business of providing entertainment or recreation) are exempt from this tax. In addition, boats and yachts that are used exclusively in the trade or business of commercial fishing or of transporting persons or property for compensation or hire are exempt from this tax. The transporting of persons or property for compensation or hire includes transportation by a cruise ship (regardless of destination) or by a boat chartered with a pilot. These may be exempt from the tax provided that the other conditions for exemption are met.

Effective date of tax

The luxury excise tax on boats was enacted as part of the Omnibus Budget Reconciliation Act of 1990, which included increases in the rates of several existing excise taxes. The luxury excise tax applies to sales after December 31, 1990, and before January 1, 2000.

Explanation of Provision

The bill would repeal the luxury excise tax on boats.

Effective Date

The repeal would be effective on January 1, 1991 (the date of imposition of the tax).

3. H.R. 2550, "The Leading Employers into Apprentice Partnerships Act" (Messrs. Grandy, Rangel, Houghton, and Morrison)

Present Law

Code section 501(c)(3) lists certain types of organizations that are exempt from taxation, including those "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes...." Charitable contributions to these organizations are deductible under Code section 170, subject to certain percentage limitations. Payments to these organizations that are ordinary and necessary business expenses are deductible under section 162.

Present law provides no special tax incentive for apprenticeship programs.

Explanation of Provisions

Tax exemption

The bill would specifically exempt apprenticeship education organizations from taxation. Apprenticeship education organizations would be organizations that were organized and operated solely for purposes of administering a qualified apprenticeship education program and that satisfied certain additional organizational tests. A qualified apprenticeship education program would be a program which:

(1) was operated in conjunction with local school systems, community colleges, and trade schools;

(2) placed "qualified students" in local apprenticeship positions related to the courses of study of the students;

(3) established restrictions on the work that may be performed by the students to ensure that the work is appropriate to the educational objectives of the program;

(4) limited each student to 20 hours of work a week as an apprentice;

(5) required the students to be paid at no more than minimum wage; and

(6) restricted the number of students that are related to contributors to the organization.

"Qualified students" would be (i) full-time students in a high school or community college and (ii) part-time students in a graduate equivalency degree program or community college who are age 18 or older.

Tax credit

The bill also would permit a 20-percent income tax credit for contributions made by businesses to any apprenticeship education organization. The deduction to employers for contributions to such organizations would not be reduced by the amount of the credit.

Effective Date

The bill would apply to years beginning after December 31, 1991.

4. H.R. 3651, Restoring the Exclusion From Gross Income for Income From Discharge of Qualified Real Property Business Indebtedness (Mr. Shaw)

Present Law

Present law generally requires taxpayers to include in gross income the amount of any discharge of indebtedness (sec. 61(a)(12)). Taxpayers are not required to include in gross income the amount of any discharge that occurs (1) in a case arising under title 11 of the United States Code (relating to bankruptcy), (2) when the taxpayer is considered to be insolvent, or (3) from certain farm indebtedness (sec. 108(a)).

Prior to 1986, in the case of a discharge of qualified business indebtedness, a taxpayer could elect to reduce the basis of depreciable assets instead of including the amount of the discharge in gross income. Qualified business indebtedness was, for a corporation, any indebtedness incurred by the corporation or, for an individual, indebtedness incurred by the individual in connection with property used in the individual's trade or business.

Explanation of Provision

In the case of a discharge of qualified real property indebtedness, a taxpayer would be permitted to elect to reduce the basis of depreciable assets instead of including the amount of the discharge in gross income. Qualified real property indebtedness is, for a corporation, indebtedness incurred by the corporation in connection with any real property, or, for an individual, indebtedness incurred by the individual in connection with real property used in the individual's trade or business.

Effective Date

The bill would apply to discharges after December 31, 1991, in taxable years ending after that date.

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