Joint Committee on Taxation
June 9, 1989
JCX-17-89

H.R. 1761: CORPORATE MINIMUM TAX[1]

Scheduled for Markup by the
Ways and Means Subcommittee
on Select Revenue Measures

Present Law

Under present law, corporations are subject to an alternative minimum tax which is payable, in addition to all other tax liabilities, to the extent that it exceeds the corporation's regular income tax owed. The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of the exemption amount. Alternative minimum taxable income is the corporation's taxable income increased by the corporation's tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the deferral of income resulting from the regular tax treatment of those items. The exemption amount is $40,000, reduced (but not below zero) by 25 percent of the amount by which alternative minimum taxable income exceeds $150,000. The foreign tax credit (computed based on items of alternative minimum taxable income), and to a limited extent the regular investment tax credit, may be used to offset the alternative minimum tax.

Where a corporation pays the alternative minimum taxable income, the amount of the tax paid (to the extent attributable to adjustments relating to timing differences with the regular tax) is allowed as a credit against the regular tax in future years. This credit (known as the alternative minimum tax credit) cannot be used to reduce tax below the tentative minimum tax in subsequent years.

Also, net operating losses, foreign tax credits, and investment tax credits cannot be used to offset, in the aggregate, more than 90 percent of the pre-foreign tax credit minimum tax which would otherwise be determined.

Adjustments and preferences are provided for accelerated depreciation, mining exploration and development costs,

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[1] For more details on present law, background, and issues involved, see Joint Committee on Taxation pamphlet, <u>Description of H.R. 1761 Relating To Simplification of Corporate Minimum Tax</u> (JCS-14-89), May 25, 1989.

certain long-term contracts, pollution control facilities, certain installment sales, Merchant Marine Capital Construction Funds, special insurance deductions, percentage depletion, excess intangible drilling costs over 65 percent of oil and gas income, certain debt reserves of financial institutions, tax-exempt interest on certain newly issued private activity bonds, and charitable deductions of appreciated property.

In addition, in computing alternative minimum taxable income, for taxable years beginning before 1990, alternative minimum taxable income is increased by one-half of the amount by which the corporation's pre-tax book income exceeds the corporation's alternative minimum taxable income (determined without regard to this adjustment and without regard to net operating losses). Book income generally is the amount that the corporation discloses on its financial statement prepared for creditors, shareholders, regulatory purposes, and so forth.

For taxable years beginning after 1989, the adjustment for book income no longer applies and, instead, alternative minimum taxable income is increased by an amount equal to 75 percent of the amount by which adjusted current earnings exceed alternative minimum taxable income (before this adjustment). In general, adjusted current earnings means alternative minimum taxable income as computed above with additional adjustments. These adjustments generally follow the rules presently applicable to corporations in computing their earnings and profits. Thus, for example, depreciation is computed using the alternative depreciation system used for earnings and profits purposes. For depreciation on property placed in service before 1990, the remaining ACRS basis (remaining minimum tax basis for property to which the new ACRS system applies) is recovered over the remaining ADR midpoint life. In addition, the amount of the deduction for certain items such as depreciation and depletion, cannot exceed the corporation's book treatment of the item, based on a present value computation.

Explanation of the Bill

In general.--H.R. 1761 would simplify the corporate minimum tax for taxable years beginning after 1989 by repealing the adjusted current earnings (ACE) preference as a separate preference and by integrating its component items into the regular minimum tax as separate preferences. Thus, those ACE preferences integrated into the regular minimum tax would become full preferences rather than 75-percent preferences, as under present law.

Depreciation.--Under the bill, generally, depreciation would be computed by using the present law minimum tax treatment (sec. 56(a)(1)) for tangible property placed in service in taxable years beginning before 1990 and the alternative depreciation system for property placed in service thereafter. Thus, depreciation on tangible property placed in service before 1981 or to which the original ACRS system applies would generally not be treated as a preference; depreciation on tangible property placed in service in taxable years beginning before 1990 to which the new ACRS system applies would continue to be treated as under present law (i.e., using the alternative depreciation system, but with 150 percent declining balance method for property other than real property); and depreciation on property placed in service in taxable years beginning after 1989 to which the new ACRS system applies would use the alternative depreciation system. Depreciation shown on the taxpayer's books would not be taken into account in determining alternative minimum taxable income. This method of depreciation would apply to individuals as well as corporations.

<u>IDCs, etc</u>.--In the case of intangible drilling costs, the earnings and profits method (i.e., 60-month amortization for productive wells) would apply, without regard to the book method used by the taxpayer. The allowance for depletion would be determined under the cost depletion method without regard to the method used for book purposes.

<u>Other preference items</u>.--The remaining items of the adjusted current earnings preference would be treated as separate minimum tax preferences. Thus, for example, tax-exempt interest would be fully included in the minimum taxable income of corporations and the dividends received deduction would not be allowed (except in certain parent-subsidiary situations for which a deduction is presently provided under ACE).

Further, the bill would make several additional minor changes. The corporate preference for circulation expenses would be conformed to the individual preference (i.e., 3-year amortization). Gain on installment sales with respect to which interest is paid at the tax underpayment rate would be allowed minimum tax installment sale treatment since appropriate interest is being paid for the right to defer payment of the tax. The special treatment of annuities would be deleted as unnecessary by reason of the exceptions added by the Technical and Miscellaneous Revenue Act of 1988.

<u>Efective date</u>.--The bill would apply to taxable years beginning after December 31, 1989.

Revenue Effect of the Bill

(In $ Billions by Fiscal Year)

1990	1991	1992	1993	1994	1990-1994
-2.3	-1.7	-0.1	*	*	-4.2

* = Loss of less than $50 million.

Possible Option

A possible option may be offered at a later time.