DESCRIPTION OF REVENUE OFFSETS FOR MEDICAL SAVINGS ACCOUNT PROVISIONS CONTAINED IN H.R. 4250, THE "PATIENT PROTECTION ACT OF 1998"

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of the

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INTRODUCTION

On July 23, 1998, the House Committee on Rules is scheduled to consider a rule for H.R. 4250, the "Patient Protection Act of 1998."

This document,[1] prepared by the staff of the Joint Committee on Taxation, describes certain proposals to be offered as an amendment to the bill. These proposals are intended to provide revenue offsets to the provisions of section 3201 of the bill, relating to expansion of the availability of medical savings accounts. In addition to these revenue offsets, it is intended that the net total of H.R. 2676, the "Internal Revenue Service Restructuring and Reform Act of 1998," which was reserved for future tax reductions, will be used to the extent necessary to offset the revenue effects of section 3201 of the bill.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Revenue Offsets for Medical Savings Account Provisions Contained in H.R. 4250, the "Patient Protection Act of 1998"* (JCX-56-98), July 23, 1998.

DESCRIPTION OF REVENUE OFFSETS

A. Restrict 10-Year Net Operating Loss Carryback Rules for Specified Liability Losses

Present Law

Under present law, that portion of a net operating loss that qualifies as a "specified liability loss" may be carried back 10 years rather than being limited to the general two-year carryback period. A specified liability loss includes amounts allowable as a deduction with respect to product liability, and also certain liabilities that arise under Federal or State law or out of any tort of the taxpayer. In the case of a liability arising out of a Federal or State law, the act (or failure to act) giving rise to the liability must occur at least 3 years before the beginning of the taxable year. In the case of a liability arising out of a tort, the liability must arise out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurred at least three years before the beginning of the taxable year. A specified liability loss cannot exceed the amount of the net operating loss, and is only available to taxpayers that used an accrual method of accounting throughout the period that the acts (or failures to act) occurred.

Description of Proposal

Under the proposal, specified liability losses would be limited to product liability losses and amounts allowable as a deduction (other than a deduction under section 468(a)(1) or 468A(a)) that are in satisfaction of a liability under a Federal or State law requiring the reclamation of land, decommissioning of a nuclear power plant (or any unit thereof), dismantlement of a drilling platform, remediation of environmental contamination, or a payment under any workers compensation act (within the meaning of section 461(h)(2)(C)(i)), if the act (or failure to act) giving rise to such liability occurs at least 3 years before the beginning of the taxable year. As under present law, the specified liability loss (as redefined) cannot exceed the amount of the net operating loss and is only available to taxpayers that used an accrual method of accounting throughout the period that the act (or failure to act) giving rise to the liability occurred. No inference regarding the interpretation of the specified liability loss carryback rules under present law is intended.

Effective Date

The proposal would be effective for net operating losses arising in taxable years ending after the date of enactment.

B. Clarify Definition of "Subject to" Liabilities Under Section 357(c)

Present Law

Present law provides that the transferor of property recognizes no gain or loss if the property is exchanged solely for qualified stock in a controlled corporation (sec. 351). Code section 357(c) provides that the transferor generally recognizes gain to the extent that the sum of the liabilities assumed by the controlled corporation and the liabilities to which the transferred property is subject exceeds the transferor's basis in the transferred property. If the transferred property is "subject to" a liability, Treasury regulations have indicated that the amount of the liability is included in the calculation regardless of whether the underlying liability is assumed by the controlled corporation. Treas. Reg. sec. 1.357-2(a).

The gain recognition rule of section 357(c) is applied separately to each transferor in a section 351 exchange.

The basis of the property in the hands of the controlled corporation equals the transferor's basis in such property, increased by the amount of gain recognized by the transferor, including section 357(c) gain.

Section 357(c) also applies to reorganizations described in section 368(a)(1)(D).

Description of Proposal

Under the proposal, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability is generally eliminated. First, except as provided in regulations, a recourse liability or any portion thereof is treated as having been assumed if, as determined on the basis of all facts and circumstances, the transferee has agreed and is expected to satisfy the liability or portion thereof (whether or not the transferor has been relieved of the liability). Thus, where more than one person agrees to satisfy a liability or portion thereof, only one would be expected to satisfy such liability or portion thereof. Second, except as provided in regulations, a nonrecourse liability is treated as having been assumed by the transferee of any asset subject to such liability.

In determining any increase to the basis of property transferred to the transferee as a result of gain recognized because of the assumption of liabilities under section 357, such increase shall not cause the basis to exceed the fair market value of the property (determined without regard to section 7701(g)). In addition, if gain is recognized to the transferor as the result of an assumption by a corporation of a nonrecourse liability that is also secured by any assets not transferred to the corporation, and if no person is subject to tax under the Internal Revenue Code on such gain, then for purposes of determining the basis of assets transferred, the amount of gain treated as recognized as the result of such assumption of liability shall be determined as if the liability assumed by the transferee equaled such transferee's ratable portion of the liability, based on the relative fair market values (determined without regard to section 7701(g)) of all

assets subject to such nonrecourse liability.

The Treasury Department has authority to prescribe such regulations as may be necessary to carry out the purposes of the provision. Where appropriate, the Treasury Department may also prescribe regulations which provide that the manner in which a liability is treated as assumed under the provision is applied elsewhere in the Code.

No inference regarding the tax treatment under present law is intended.

Effective Date

The proposal would be effective for transfers after the date of enactment.

C. Limit Use of Non-Accrual Experience Method of Accounting to Amounts to Be Received for the Performance of Qualified Professional Services

Present Law

An accrual method taxpayer generally must recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. An accrual method taxpayer may deduct the amount of any receivable that was previously included in income if the receivable becomes worthless during the year.

Accrual method taxpayers are not required to include in income amounts to be received for the performance of services which, on the basis of experience, will not be collected (the "non-accrual experience method"). The availability of this method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay such amount.

Description of Proposal

The non-accrual experience method would apply only to amounts to be received for the performance of qualified personal services. Amounts to be received for the performance of all other services would be subject to the general rule regarding inclusion in income. Qualified personal services are personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting. As under present law, the availability of the method would be conditioned on the taxpayer not charging interest or a penalty for failure to timely pay such amounts.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1998. Any change required as a result of the proposal would be considered a change in the taxpayer's method of accounting, initiated by the taxpayer with the consent of the Secretary. Any required section 481(a) adjustment would be taken into account ratably over a three-year period.

D. Information Returns Relating to the Discharge of Indebtedness by Certain Entities

Present Law

Under section 61(a)(12), a taxpayer's gross income includes income from the discharge of indebtedness. Section 6050P requires "applicable entities" to file information returns with the IRS regarding any discharge of indebtedness of $600 or more.

The information return must set forth the name, address, and taxpayer identification number of the person whose debt was discharged, the amount of debt discharged, the date on which the debt was discharged, and any other information that the IRS requires to be provided. The information return must be filed in the manner and at the time specified by the IRS. The same information also must be provided to the person whose debt is discharged by January 31 of the year following the discharge.

"Applicable entities" include: (1) the FDIC, the RTC, the National Credit Union Administration, and any successor or subunit of any of them; (2) any financial institution (as described in secs. 581 (relating to banks) or 591(a) (relating to savings institutions)); (3) any credit union; (4) any corporation that is a direct or indirect subsidiary of an entity described in (2) or (3) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities; and (5) an executive, judicial, or legislative agency (as defined in 31 U.S.C. sec. 3701(a)(4)).

The penalties for failure to file correct information reports with the IRS and to furnish statements to taxpayers are similar to those imposed with respect to a failure to provide other information returns. For example, the penalty for failure to furnish statements to taxpayers is generally $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

Description of Proposal

The proposal would require that information reporting on discharges of indebtedness also be done by any organization a significant trade or business of which is the lending of money (such as finance companies and credit card companies whether or not affiliated with financial institutions).

Effective Date

The proposal would be effective with respect to discharges of indebtedness after December 31, 1998.

E. Clarify and Expand Mathematical Error Procedures

Present Law

Taxpayer identification numbers ("TIN"s)

The Internal Revenue Service ("IRS") may deny a personal exemption for a taxpayer, the taxpayer's spouse or the taxpayer's dependents if the taxpayer fails to provide a correct TIN for each person for whom the taxpayer claims an exemption. This TIN requirement also indirectly affects other tax benefits currently conditioned on a taxpayer being able to claim a personal exemption for a dependent (e.g., head-of-household filing status and the dependent care credit). Other tax benefits, including the adoption credit, the child tax credit, the Hope Scholarship credit and Lifetime Learning credit, and the earned income credit also have TIN requirements. For most individuals, their TIN is their Social Security Number ("SSN"). The mathematical and clerical error procedure currently applies to the omission of a correct TIN for purposes of personal exemptions and all of the credits listed above except for the adoption credit.

Mathematical or clerical errors

The IRS may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and a period of 60 days to request that the IRS abate its assessment. The IRS may not proceed to collect the amount of the assessment until the taxpayer has agreed to it or has allowed the 60-day period for objecting to expire. If the taxpayer files a request for abatement of the assessment specified in the notice, the IRS must abate the assessment. Any reassessment of the abated amount is subject to the ordinary deficiency procedures. The request for abatement of the assessment is the only procedure a taxpayer may use prior to paying the assessed amount in order to contest an assessment arising out of a mathematical or clerical error. Once the assessment is satisfied, however, the taxpayer may file a claim for refund if he or she believes the assessment was made in error.

Description of Proposal

For purposes of the mathematical and clerical error procedure, the proposal would provide that a correct TIN is a TIN assigned by the Social Security Administration (or in certain limited cases, the IRS) to the individual identified on the return. The IRS would be authorized to determine that the individual identified on the tax return corresponds in every aspect (including name, age, date of birth, and SSN) to the individual to whom the TIN is issued. The IRS would be authorized to use the mathematical and clerical error procedure to deny eligibility for the dependent care tax credit, the child tax credit, and the earned income credit even though a correct TIN has been supplied if the IRS determines that the statutory age restrictions for eligibility for

any of the respective credits is not satisfied (e.g., the TIN issued for the child claimed as the basis of the child tax credit identifies the child as over the age of 17 at the end of the taxable year).

Effective Date

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

F. Add Vaccines Against Rotavirus Gastroenteritis to the List of Taxable Vaccines

Present Law

A manufacturer's excise tax is imposed at the rate of 75 cents per dose (sec. 4131) on the following vaccines routinely recommended for administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, and varicella (chicken pox). The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. This program provides a substitute Federal "no fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers. All persons immunized after September 30, 1988, with covered vaccines must pursue compensation under this Federal program before bringing civil tort actions under State law.

Description of Proposal

The proposal would add vaccines against rotavirus gastroenteritis to the list of taxable vaccines.

Effective Date

The proposal would be effective for vaccine purchases the day after the date of enactment. No floor stocks tax would be collected for amounts held for sale on that date.