DESCRIPTION OF PROPOSED AMENDMENTS TO THE REVENUE PROVISIONS OF THE BUDGET SUMMIT AGREEMENT

Scheduled for Markup Consideration

by the

HOUSE COMMITTEE ON WAYS AND MEANS

On October 10, 1990

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of a proposed amendment to the revenue provisions of the Budget Summit Agreement for consideration by the House Committee on Ways and Means on October 10, 1990.

The proposed amendments are categorized in the following order: (A) Regressivity offset--increase earned income tax credit; and (B) Revenue-raising provisions. Also, preceding the descriptions of proposed amendments is a list of revenue provisions to be deleted from the Budget Summit Agreement.

The descriptions of the proposals include present law, the Budget Summit Agreement, proposed amendments to the Budget Summit Agreement, and effective date.

A separate document provides revenue estimates for fiscal years 1991-1995 of the proposed amendments to the Budget Summit Agreement.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Proposed Amendments to the Revenue Provisions of the Budget Summit Agreement (JCX-28-90), October 10, 1990.

Revenue Items Deleted From the Budget Summit Agreement

The Proposed Amendments do not include certain revenue provisions that were included as part of the Budget Summit Agreement. Specifically, the Proposed Amendments do not include:

- State and local Social Security offset;
- Enterprise zones;
- Energy incentives;
- Extension of the research and experimentation tax credit and the low-income rental housing credit; and
- Additional growth incentives for certain small businesses.

A. Regressivity Offset: Increase Earned Income Tax Credit

Present Law

An eligible taxpayer is allowed an advance refundable tax credit based on the taxpayer's earned income (sec. 32). Taxpayers eligible for the credit include: (1) married individuals filing a joint return who are entitled to a dependency exemption for a child, (2) a head of household, or (3) a surviving spouse.

In 1990, the earned income tax credit (EITC) is equal to 14 percent of the first $6,810 of earned income. The credit is phased out at a rate of 10 percent of the amount of adjusted gross income (or, if greater, earned income) that exceeds $10,730. The EITC is fully phased out at $20,264 of income. The dollar amounts are adjusted annually for changes in the cost of living, so that the maximum amount of the credit and the maximum amount of income eligible for the credit increase with inflation.

For 1990, the maximum amount of the credit is $953, and is projected to increase to $994 for 1991.

Summit Agreement

Under the agreement, the EITC would be modified in a manner that increases the tax expenditure related to the credit by $5 billion over the 5-year budget period.

Effective Date

Effective for taxable years beginning after December 31, 1990.

B. Revenue Raising Provisions

1. Energy Excise Taxes

a. Increase Highway and Motorboat Fuels Excise Taxes

Present Law

Federal excise taxes are imposed on the sale of gasoline (9 cents per gallon), diesel fuel (15 cents per gallon), and special motor fuels (9 cents per gallon) used in highway transportation and motorboats. A 6-cents-per-gallon exemption is provided from these taxes for certain fuels blended with alcohol, i.e., gasohol.

The 9-cents-per-gallon taxes on gasoline and special motor fuels and the 15-cents-per-gallon tax on diesel fuel are scheduled to expire after September 30, 1993. The gasohol exemption also is scheduled to expire after September 30, 1993.

Revenues from the highway and motorboat fuels taxes are dedicated to the Highway Trust Fund and the Aquatic Resources Trust Fund, respectively. Amounts equal to 1 cent per gallon of the highway motor fuels taxes are set aside for the Mass Transit Account of the Highway Trust Fund.

Currently, an additional tariff of 15.85 cent per liter applies to imported ethanol to offset the gasohol exemption. Further, section 225 of the Customs and Trade Act of 1990 (Public Law 101-382) extended a provision authorizing under prescribed conditions the duty-free entry of ethanol from Caribbean Basin Initiative (CBI) countries. The additional tariff on imported ethanol is scheduled to expire on December 31, 1992, and the effective date for the CBI ethanol provision is linked to the expiration of the tariff provision. Thus, it too would expire on December 31, 1992, unless the tariff provision is extended.

Summit Agreement

Increase the present highway (including gasohol) and motorboat fuels taxes by 5 cents per gallon, effective on December 1, 1990, and an additional 5 cents per gallon on July 1, 1991.

Motor fuels used in off-highway uses (e.g., agriculture), by States and local governments, and by other persons whose use is fully exempt from the present highway and motorboat fuels taxes are not subject to the increased rates.

One-half of the revenues from the increases derived each year in the highway and motorboat tax rates are dedicated to the Highway and Aquatic Resources Trust Funds, respectively, with the remaining 50 percent of the increased revenues being retained in general revenues.

Provide that at least 95 percent of the appropriated amounts (from the highway account of the Highway Trust Fund) attributable to increased revenues dedicated under the proposal to the Trust Fund are to be allocated and apportioned to the State from which the revenues are derived.

Twenty percent of the amounts attributable to increased revenues dedicated to the Highway Trust Fund are set aside for the mass transit account of that Trust Fund.

The present-law fuels tax rates (and gasohol exemption) are extended through September 30, 1995; the increases in the tax rates (both the Trust Fund and deficit reduction portions) also expire after that date. The present-law (October 1, 1993) expiration of Highway Trust Fund expenditure authority is retained.

Effective date.--Effective on December 1, 1990. Floor stocks taxes are imposed on December 1, 1990, and July 1, 1991, on inventories held on those dates on which tax at the new rates has not previously been paid.

Proposed Amendment

Modify the Summit Agreement to reduce the increase in the present highway and motorboat fuels taxes to 5 cents per gallon, effective on December 1, 1990, and an additional 4 cents per gallon on July 1, 1991, and to clarify that the additional tariff on ethanol and, consequently, the CBI ethanol provision, also is extended through September 30, 1995.

Effective Date

Same as Summit Agreement.

b. Impose Petroleum Excise Tax

Present Law

Under present law two excise taxes are imposed on crude oil and imported petroleum products to finance the Hazardous Substance Superfund and the Oil Spill Liability Trust Fund. No such taxes are imposed for general revenues.

The Superfund tax rate is 9.7 cents per barrel of (a) crude oil received at a U.S. refinery and (b) imported petroleum products. The Oil Spill Liability Trust Fund tax rate is 5 cents per barrel for the same items. Both of these environmental excise taxes apply in the United States and in U.S. possessions. The taxes also apply to exports of domestic products. Unless certain dollar limits are exceeded, the Superfund tax expires after December 31, 1991, and the oil spill tax expires after December 31, 1994.

Summit Agreement

Impose an excise tax at a rate of 2 cents per gallon on refined petroleum products, including gasoline, diesel fuel, commercial and noncommercial aviation fuels, kerosene, residual fuel oil, and distillate fuel oil. Products not used as fuel, such as asphalt, lubricants, waxes, and nonfuel feedstocks are not subject to tax. In addition, exported fuels, feedstocks, and fuels used in manufacturing (including agriculture) are exempt. The tax generally is paid by refiners.

For fuels other than highway and motorboat fuels, amounts collected are to be dedicated to general revenues. For the highway and motorboat fuels, amounts collected are to be dedicated 50 percent to the highway and aquatic resources trust funds, respectively, and 50 percent to general revenues. Twenty percent of the amounts attributable to increased revenues dedicated to the Highway Trust Fund are set aside for the mass transit account of that Trust Fund.

Effective date.--The tax is effective on December 1, 1990, with a floor stocks tax being imposed on that date.

Proposed Amendment

Modify the Summit Agreement to exempt home heating oil.

Effective Date

Same as Summit Agreement.

2. Increase Tobacco Excise Taxes

Present Law

The following is a listing of the Federal excise taxes imposed on tobacco products under present law:

Article	Tax imposed
Cigars	
Small cigars	$0.75 per thousand.
Large cigars	8.5% of suggested wholesale price, up to $20 per thousand.
Cigarettes	
Small cigarettes	$8.00 per thousand (16 cents per pack of 20 cigarettes).
Large cigarettes	$16.80 per thousand.
Cigarette papers	$0.005 per 50 papers.
Cigarette tubes	$0.01 per 50 tubes.
Chewing tobacco	$0.08 per pound.
Snuff	$0.24 per pound.
Pipe tobacco	$0.45 per pound.

Summit Agreement

Increase by 25 percent the current excise taxes on all tobacco products, including cigarettes, cigars, chewing tobacco, snuff, and pipe tobacco (e.g., increase the tax on a pack of 20 small cigarettes from 16 cents to 20 cents per pack), effective January 1, 1991. Further increase by the same dollar amount as the previous 25-percent increase the excise taxes on all tobacco products (e.g., increase the tax on a pack of 20 small cigarettes from 20 cents to 24 cents per pack), effective January 1, 1993. Impose floor stocks taxes at the time of each rate increase.

Effective Date

The first rate increase described above is effective on January 1, 1991. The second rate increase described above is effective on January 1, 1993.

3. Increase Excise Taxes on Distilled Spirits, Beer, and Wine

Present Law

Under present law, the following alcoholic beverages are subject to excise taxes at the following rates:

Beverage	Tax imposed
Distilled spirits	$12.50 per proof gallon.
Beer	$9.00 per barrel generally[1].
Still wines	
Up to 14 percent alcohol	$0.17 per wine gallon.
14 to 21 percent alcohol	$0.67 per wine gallon.
21 to 24 percent alcohol[2]	$2.25 per wine gallon.
Artificially carbonated wines	$2.40 per wine gallon.

Summit Agreement

The OMB description of the summit agreement provided for the following excise tax rate changes[3]:

(1) Increase the distilled spirits tax rate by $1.50 per proof gallon, from $12.50 per proof gallon to $14.00 per proof gallon.

(2) Double the tax rate on beer from $9.00 per barrel (16 cents per six pack) to $18.00 per barrel (32 cents per six pack).

(3) Increase the tax rate on wine with up to 14 percent alcohol content (commonly referred to as table wine) from $0.17 per wine gallon (3 cents on a 750-milliliter bottle) to $1.27 per wine gallon (25 cents on a 750-milliliter bottle).

(4) Increase the tax rate on wine with 14 to 21 percent alcohol content (commonly referred to as fortified wine) from $0.67 per wine gallon (13 cents on a 750-milliliter bottle) to $1.77 per wine gallon (35 cents on a 750-milliliter bottle).

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[1] The tax rate is $7.00 per barrel for certain small brewers.

[2] Wines containing more than 24 percent alcohol are taxed as distilled spirits.

[3] The OMB description further indicated that the summit agreement contemplated additional changes, if necessary, to reach a revenue target of $10 billion during FY 1991-1995.

(5) Increase the tax rate on wine with 21 to 24 percent alcohol content from $2.25 per wine gallon (45 cents on a 750-milliliter bottle) to $3.35 per wine gallon (67 cents on a 750-milliliter bottle).

(6) Increase the tax rate on artificially carbonated wine from $2.40 per wine gallon (48 cents on a 750-milliliter bottle) to $3.50 per wine gallon (70 cents on a 750-milliliter bottle).

Small producer exception.--The present-law small domestic producer rate for beer is modified and a comparable rule is extended to wine producers. Under these rules, the present-law $7 per barrel rate remains in effect for the first 30,000 barrels of beer produced by domestic breweries with total production for the calendar year not exceeding 60,000 barrels. Similarly, the first 100,000 gallons of wine produced by domestic wineries with total production for the calendar year not exceeding 200,000 gallons are taxed at present-law rates.

Effective date.--The rate increases are effective on January 1, 1991, with floor stocks taxes being imposed on that date.

Proposed Amendment

Adopt the rate increases specified in the OMB description of the summit agreement.

Effective Date

The rate increases are effective on January 1, 1991, with floor stocks taxes being imposed on that date.

4. Luxury Excise Tax

Present Law

No luxury excise taxes are imposed under present law. Although a number of luxury items were subject to various excise taxes in the past, those excise taxes were repealed in the Excise Tax Reduction Act of 1965.

Summit Agreement

Impose a 10-percent excise tax on the portion of the retail price of the following items that exceeds the thresholds specified below:

(1) Automobiles above $30,000.--An automobile is any passenger automobile manufactured primarily for use on public streets, roads, and highways that is rated at 6,000 pounds unloaded gross vehicle weight or less. This includes trucks and vans, except that only trucks and vans with a loaded gross vehicle weight of 6,000 pounds or less are subject to this tax. (Limousines are subject to tax regardless of weight.) Also, the tax does not apply to the sale or leasing of any passenger vehicle for use by the purchaser or lessee exclusively in the active conduct of a trade or business of transporting persons or property for compensation or hire. Thus, for example, the tax will apply to a vehicle purchased by a business and used to transport its employees or officers.

(2) Boats and yachts above $100,000.--Boats and yachts that are used exclusively 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.

(3) Jewelry above $5,000.--The tax applies on an item-by-item basis. Custom fabrication of jewelry also is subject to this tax. Watches are included as jewelry.

(4) Furs above $5,000.--The tax applies to items made from fur or in which fur is a major component. It does not apply to leather or to artificial fur.

Tax applicable only to newly manufactured items.--This tax applies only to the first retail sale of newly manufactured items subject to the tax. It does not apply to subsequent sales of these items. Thus, for example, if a jeweler creates a new brooch which sells for $10,000, that item is subject to this tax. If, however, the jeweler sells an antique brooch for $10,000, that item is not subject to this tax.

Anti-abuse rules.--An anti-abuse rule prevents businesses from briefly using items subject to this tax in their trade or business and then selling them a short time thereafter as a way of avoiding this tax. An additional anti-abuse rule would prevent the avoidance of the tax on automobiles, boats, and yachts through separate purchases of major component parts. Thus, for example, if the taxpayer purchases a sailboat from a distant boatyard without an inboard motor or mast, and purchases and has installed locally the inboard motor and mast, those purchases would be aggregated for purposes of this tax.

Special rule for leases.--A special rule applies to the leasing of boats by a person in the trade or business of leasing. These lessors do not pay the tax on their purchase of these items; instead, their leasing of these items is treated as a sale (parallel to present law excise tax rules). Thus, a pro-rata portion of the tax is due on each lease payment, unless the lease payment is being made by a person who would be exempt from the tax (because of the nature of the use of the item) if the person owned the item.

Exemptions.--The tax on automobiles, boats, and yachts does not apply to the sale of those items to the Federal government or to a State or local government for use exclusively in police or other law enforcement activities or to any person for use exclusively in providing emergency medical services.

Tax applicable to imports.--This tax applies to these items upon their importation into the United States, unless the item is being imported by someone in the trade or business for subsequent retail sale (in which instance the subsequent retail sale would be subject to tax).

Tax inapplicable to exports.--This tax does not apply to exported items.

Effective date.--This tax applies to retail sales occurring on or after January 1, 1991.

Proposed Amendment

Under the proposed amendment, the tax would also apply to airplanes above $100,000, with exceptions for: aircraft used exclusively in the trade or business of transporting persons or property for hire; cropdusters; certain helicopters used exclusively in transporting individuals, equipment, or supplies in the exploration, development or removal of oil, gas, or hard minerals, or in planting or cutting of trees; aircraft used exclusively for police or emergency medical purposes; and aircraft used exclusively for flight training purposes. The special leasing rules for boats also apply to aircraft.

Effective Date

Same as Summit Agreement.

5. Expand Chemicals Subject to Excise Tax on Ozone-Depleting Chemicals

Present Law

In general

An excise tax is imposed on certain ozone-depleting chemicals sold or used by the manufacturer, producer, or importer. The Code also imposes a tax on imported products if any ozone-depleting chemical was used as an input in the manufacture or production of such product. The amount of tax is determined by multiplying a base tax amount by an "ozone-depleting factor."

A reduced rate of tax is provided for chemicals used in rigid foam insulation, and for Halon-1211, Halon-1301, and Halon-2402, for calendar years 1990-1993. The tax does not apply to feedstock chemicals used in the production or manufacture of other ozone-depleting or non-ozone-depleting chemicals. The tax imposed does not apply to any ozone-depleting chemical which is diverted or recovered in the United States as part of a recycling process. Certain exports of ozone-depleting chemicals are exempt from tax.

Ozone-depleting chemicals

Ozone-depleting chemicals which are subject to tax are:

CFC-11
CFC-12
CFC-113
CFC-114
CFC-115
Halon-1211
Halon-1301
Halon-2402

The chemicals subject to tax are those identified as ozone-depleting under the Montreal protocol as in effect on September 14, 1989. Subsequent changes to the list of ozone-depleting chemicals under the Montreal protocol does not change the list of chemicals subject to tax without further Congressional action.

Base tax amount

For calendar years 1990 and 1991, the base tax amount generally is $1.37 per pound of ozone-depleting chemical; for 1992, the base tax amount is $1.67 per pound; and for 1993 and 1994, the base tax amount is $2.65 per pound. For calendar years after 1994, the base tax amount is increased by $0.45 per pound per year.

Modifications to the Montreal protocol

In June of 1990, the Montreal Protocol on Substances that Deplete the Ozone Layer was amended to expand the list of controlled chemicals and to make other changes. The list of controlled chemicals was expanded to include carbon tetrachloride, methyl chloroform, CFC-13, CFC-111, CFC-112, CFC-211, CFC-212, CFC-213, CFC-214, CFC-215, CFC-216, and CFC-217. Under the amendments to the protocol, consumption and production controls are not applicable to carbon tetrachloride prior to January 1, 1995; and consumption and production controls are not applicable to methyl chloroform, CFC-13, CFC-111, CFC-112, CFC-211, CFC-212, CFC-213, CFC-214, CFC-215, CFC-216, and CFC-217 prior to January 1, 1993.

Summit Agreement

The proposal adds carbon tetrachloride, methyl chloroform, CFC-13, CFC-111, CFC-112, CFC-211, CFC-212, CFC-213, CFC-214, CFC-215, CFC-216, and CFC-217 to the list of chemicals taxed under the current excise tax on ozone-depleting chemicals, and the base tax amount would be that generally applicable for 1991 and subsequent years.

Effective date.--The proposal is effective on January 1, 1991. In addition, the proposal provides for a floor stocks tax applicable to taxed chemicals held for sale or use as of January 1, 1991. No deposits of tax payments which arise from tax liabilities on carbon tetrachloride, methyl chloroform, CFC-13, CFC-111, CFC-112, CFC-211, CFC-212, CFC-213, CFC-214, CFC-215, CFC-216, and CFC-217 need be made prior to April 1, 1991.

Proposed Amendment

Amend the base tax rates applicable to the newly taxed chemicals as follows: the base tax rate for newly taxed chemicals during calendar year 1992 is $1.37 per pound of ozone-depleting chemical; $1.67 per pound for calendar year 1993; $3.00 per pound for calendar year 1994; and $3.10 per pound for calendar year 1995.

Effective Date

Same as the Summit Agreement.

6. Treatment of Salvage and Subrogation of Property and Casualty Insurance Companies

<u>Present Law</u>

A property and casualty insurance company, in determining its underwriting income for Federal income tax purposes, may deduct losses incurred. The deduction for losses incurred includes losses paid during the year and the increase in discounted unpaid losses for the year. Present law requires paid losses to be reduced by the increase in salvage (including subrogation claims) recoverable. Since 1947, Treasury regulations have provided an exception to the requirement that paid losses be reduced by salvage, if under applicable State law or State insurance rules the salvage may not be treated as an asset for statutory accounting purposes. This regulatory exception was removed, in temporary Treasury regulations originally promulgated December 30, 1987, but the effective date of the temporary regulations has been deferred several times, and at present the temporary regulations are technically in effect for taxable years beginning after December 31, 1989.

<u>Summit Agreement</u>

Reduce the deduction allowed to property and casualty insurance companies for losses incurred, both paid and unpaid, by estimated recoveries of salvage (including subrogation claims) attributable to such losses, whether or not the salvage is treated as an asset for statutory accounting purposes. Authorize the Treasury Department to issue regulations providing for discounting of salvage taken into account under the proposal.

This proposal is similar to a proposal contained in the President's fiscal year 1991 budget.

<u>Effective date</u>

Apply the proposal to taxable years beginning after December 31, 1989. Treat the change as a change in the taxpayer's method of accounting requiring a spread of the adjustment over a period not to exceed eight years. The amount of the adjustment is the difference between the amount of unreduced loss reserves at the end of the taxable year immediately preceding the first taxable year beginning after December 31, 1989, and the amount of the reduced loss reserve determined under this proposal as of the beginning of the first taxable year beginning after December 31, 1989.

7. Compliance Provisions

a. Information reporting and related provisions (including certain provisions of the Foreign Tax Equity Act (H.R. 4308))

Present Law

Information reporting and maintenance

Any corporation that is 25-percent owned by a foreign person and is either a domestic corporation or a foreign corporation that conducts a trade or business in the United States (a "reporting corporation") must furnish the IRS with such information as the Secretary may prescribe regarding transactions carried out directly or indirectly with certain foreign persons treated as related to the reporting corporation ("reportable transactions") (sec. 6038A). A related person for this purpose includes a 25-percent shareholder as well as any person that is treated as related within the meaning of sections 267(b), 707(b)(1), or 482. Current Treasury regulations require the annual filing of an information return reporting all related-party transactions. In addition, a reporting corporation is required to maintain (or cause another person to maintain), at the location, in the manner, and to the extent prescribed by regulations, any records deemed appropriate to determine the correct tax treatment of reportable transactions (sec. 6038A(a)).

Application of U.S. legal process to foreign persons

The statutory scope of general IRS summons authority extends to certain persons that are not themselves subject to tax in the United States. In addition, the Code provides that in order to avoid the consequences of the noncompliance rule (discussed below) with respect to certain reportable transactions, each foreign person that is a related party of a reporting corporation must agree to authorize the latter to accept service of process as its agent in connection with any request or summons by the IRS to examine books, records, or other materials, to produce such materials, or to take testimony related to any reportable transaction, solely for the purpose of determining the tax liability of the reporting corporation (sec. 6038A(e)(1)). Thus, assuming such authorization is given, IRS examination requests and summonses with respect to related-party transactions involving U.S. taxpayers can be served on related foreign persons through those U.S. taxpayers.

Sanctions for noncompliance

Monetary penalty.--Failure to furnish the IRS with information or to maintain records as required under section 6038A(a) and (b) is sanctioned by a monetary penalty of $10,000, and additional penalties are imposed if the failure continues more than 90 days after the IRS notifies the taxpayer of the failure (sec. 6038A(d)). The additional penalties are $10,000 for each 30-day period (or fraction thereof) during which the failure continues after the 90th day after IRS notification. An exception from liability for the monetary penalty exists in cases where the taxpayer demonstrates to the satisfaction of the Secretary that reasonable cause exists for the failure to furnish required information or maintain required records (sec. 6038A(d)(3)).

Noncompliance rule.--Failure of a related party to designate a reporting corporation as its agent for accepting service of process in connection with reportable transactions (as discussed above), or, under certain circumstances, noncompliance with IRS summonses in connection with reportable transactions, can result in the application of the noncompliance rule in computing tax liability. For certain payments to related parties in connection with reportable transactions, this rule permits the IRS to allow the reporting corporation only those deductions and amounts of cost of goods sold as shall be determined by the Secretary in the Secretary's sole discretion, based on any information in the knowledge or possession of the Secretary or on any information that the Secretary may obtain through testimony or otherwise (sec. 6038A(e)).

Prior law

The information reporting and related requirements described above reflect certain amendments made in 1989 that apply only to taxable years beginning after July 10, 1989. The information reporting and related requirements of prior law (i.e., those applicable to taxable years beginning before July 11, 1989) are less extensive. Under prior law, the requirement to file an information return reporting all transactions with related foreign persons only applied to corporations that were 50-percent owned by a foreign person. Relatedness for this purpose was defined as relatedness only within the meaning of sections 267(b), 707(b)(1), or 482. Noncompliance with this reporting requirement was sanctioned by an initial penalty of $1,000, plus additional $1,000 penalties (up to a maximum of $24,000) for each 30-day period (beginning 90 days after IRS notification) that the failure remained outstanding. The provisions of section 6038A prior to the 1989 amendments did not include the record-maintenance requirement, the agency-designation requirement for service of process, or the special noncompliance rule discussed above.

Summit Agreement

1. Apply the information reporting and related provisions of section 6038A, as amended in 1989, to any taxable year with respect to which the limitations period for

assessment of tax is still open.

2. Apply the information reporting and related provisions of section 6038A, as amended in 1989, to any foreign corporation that conducts a trade or business in the United States, and extend the application of those provisions to all tax-related items, not only transactions with related parties.

The proposals are included in the Foreign Tax Equity Act of 1990, which is pending in the House of Representatives as H.R. 4308 and in the Senate as S. 2410.

The proposals apply to any requirement to furnish information under section 6038A (as amended in 1989 and extended under the proposals) if the time for furnishing such information is after the date of enactment of the proposals, to any requirement under section 6038A (as amended in 1989 and extended under the proposals) to maintain records that were in existence at any time on or after March 20, 1990, and to any requirement to authorize a corporation to act as a limited agent under section 6038A (as amended in 1989 and extended under the proposals) if the time for authorizing such action is after the date of enactment of the proposals, without regard to the tax year involved. The proposals' monetary penalty applies to a failure to furnish information or maintain records that occurs after enactment of the proposals. In addition, in the case of a failure to furnish information or maintain records that continues more than 90 days after notice of an initial failure, the proposals' increased monetary penalty applies to continuations of the failure after enactment of the proposals.

The proposals also apply to any summons issued after the date of enactment of the proposals, without regard to the tax year involved. However, in the case of a summons for records that did exist prior to March 20, 1990, but no longer existed on March 20, 1990, the effective date of the record maintenance requirements described above has the result that the noncompliance rule would not apply to the failure to comply with a summons for the reason that the summoned records no longer exist, where those records are shown to have been discarded in the ordinary course of business prior to March 20, 1990.

3. Provide for a report to be made by the Secretary of the Treasury to the Committee, by March 1, 1992, regarding levels of compliance with Code section 482, the effectiveness of the statute of limitations provisions contained in the Chairman's mark, the use of advanced determination agreements with respect to section 482 issues, possible additional statutory provisions or administrative changes to assist the IRS in increasing compliance with section 482, and coordination of the administration of section 482 with the

administration of similar provisions of foreign tax laws and of domestic non-tax laws.

Effective date

The proposals are effective as described above.

b. Suspension of statute of limitations during proceedings to enforce certain summonses

Present Law

The statute of limitations for most tax returns (whether corporate or individual) is three years. The IRS and the taxpayer can together agree to extend the statute of limitations, either for a specified period of time or indefinitely. The taxpayer may terminate an indefinite agreement to extend the statute of limitations by providing notice to the IRS on the appropriate form. Because of the complexity of the issues involved, IRS frequently cannot complete an audit of a corporate tax return within the statutorily specified three-year period.

During an audit, IRS frequently requests informally that the taxpayer provide additional information necessary to arriving at a fair and accurate audit adjustment, if any adjustment is warranted. Not all taxpayers cooperate by providing the requested information on a timely basis. In some cases the IRS is compelled to seek information by issuing an administrative summons. Such a summons will not be enforced by judicial process unless the Government (as a practical matter, the Department of Justice) seeks and obtains an order for enforcement in Federal court. In addition, a taxpayer may petition in court to have an administrative summons quashed.

Summit Agreement

The IRS may issue a designated summons, which must be issued at least 60 days before the day on which the period for assessment of tax for the year in question (including any extensions) would otherwise expire. A designated summons may be issued by the IRS only once for any taxable year of a taxpayer.

The statute of limitations is suspended for the period that commences when a lawsuit is brought in court to either enforce or quash the designated summons and ends on the date there is a final resolution of the taxpayer's response to the summons. For these purposes, the term "final resolution" means the same as it does in section 7609(e)(2)(B). If any court requires additional compliance to any extent with the summons, the statute of limitations is suspended for an additional 120 days. If this does not occur, the assessment period would in no event expire until the 60th day after that final resolution. This provision is designed to preserve the ability of the IRS to conclude the audit and assess any taxes that may be due regardless of the length of time that it might take to obtain judicial resolution of the summons enforcement lawsuit.

These rules for suspending the statute of limitations also apply with respect to any summons issued during the 30-day period following the issuance of the designated summons pertaining to the same tax return as the designated summons. This is necessary because, for example, a designated summons may be issued to a corporation that cannot respond adequately on the grounds that the summonsed information is in the control of a shareholder; a summons to the shareholder for the same information would be necessary to obtain the summonsed information. Thus, the statute of limitations is tolled during the course of any enforcement litigation over the subsequent summons.

Effective date

Applies to any tax (regardless of whether imposed before, on, or after the date of enactment) if the statute of limitations for the assessment of the tax has not expired on the date of enactment.

c. Apply accuracy-related penalty more effectively to section 482 adjustments

Present Law

Valuation questions are frequently central to disputes between taxpayers and the IRS involving section 482. Substantial valuation overstatements are subject to penalty. A substantial valuation overstatement occurs if the value of any property claimed on a tax return is 200 percent or more of the amount determined to be correct. The penalty is 20 percent of the understatement of tax attributable to the substantial valuation overstatement.

There are a number of difficulties in applying the present-law penalties in disputes involving section 482. First, the percentage of the value that is overstated is often not as high as 200 percent, although the total of the taxes in dispute because of valuation overstatements is often millions of dollars per taxable year. Secondly, valuation misstatements in the section 482 area are often attributable to services as well as property, even though only misstatements with respect to property are subject to the penalty. Third, some section 482 adjustments are attributable to undervaluations, although the present-law penalty applies only to overvaluations.

Several modifications are to be made to the present-law penalty to target it more effectively to situations involving section 482 issues.

Summit Agreement

The present-law valuation overstatement penalty is extended to apply to specified valuation misstatements in connection with section 482. First, the penalty applies to the understatement of tax attributable to a net section 482 transfer price adjustment for the taxable year that exceeds $10,000,000. The net section 482 transfer price adjustment is the net increase in taxable income for a taxable year that results from all adjustments under section 482 in the transfer price of any property or services.

Second, the penalty also will apply in instances where the transfer price claimed on the return is 200 percent or more (or 50 percent or less) of the amount determined to be the correct transfer price under section 482.

Third, as under present law, the penalty is doubled in cases of gross valuation misstatements (where the misstatement is double or more of either the percentage or dollar amount described above).

Effective date

Effective for taxable years ending after the date of enactment.

d. Clarification that disclosure is permitted to persons providing services

Present Law

Tax returns and return information are confidential, and may not be disclosed without statutory authorization. Unauthorized disclosure is punishable by a fine, prison sentence, or private lawsuit for damages.

The IRS is permitted to disclose returns and return information to other persons to the extent necessary in connection with the processing, storage, transmission, and reproduction of such returns. Persons to whom returns and return information are disclosed pursuant to this provision are subject to the same penalties for unauthorized disclosure as are IRS employees. Although this present-law authority has been interpreted to extend to persons from whom the IRS acquires services, such as expert witnesses, the statute does not explicitly mention the provision of services.

Summit Agreement

The proposal clarifies that the IRS has the authority to disclose returns and return information to persons who provide services to the IRS, such as expert witnesses. Thus, these persons will be subject to the same penalties for unauthorized disclosure as are IRS employees. No inference that IRS did not have this authority prior to this amendment is intended.

Effective Date

Effective on the date of enactment.

8. Amortize Policy Acquisition Expenses of Insurance Companies

Present Law

In the case of a life insurance company, for purposes of determining life insurance company taxable income under the regular tax, policy acquisition expenses generally are not subject to an amortization requirement, but rather are deductible currently. In certain reinsurance transactions, however, present law requires the reinsuring company to capitalize ceding commissions and amortize them over the useful life of the asset, rather than permitting a current deduction for ceding commissions.

Under the adjusted current earnings provision of the corporate alternative minimum tax, acquisition expenses of a life insurance company are capitalized and amortized in accordance with the treatment generally required under generally accepted accounting principles.

In the case of a property and casualty insurance company, the deduction for any increase in unearned premiums for a taxable year must be reduced by 20 percent. This 20 percent reduction is intended to represent the allocable portion of expenses incurred in generating the unearned premiums. Present law provides that life insurance reserves of a property and casualty insurance company that are included in unearned premium reserves of the company are not, however, subject to the 20 percent reduction rule. Such life insurance reserves include reserves for noncancellable or guaranteed renewable accident and health insurance contracts.

Summit Agreement

Require insurance companies to amortize policy acquisition expenses on a straight-line basis over a period of 10 years.[4]

Define policy acquisition expenses for each category of insurance contract as a percentage of total premiums (net of reinsurance premiums) for that category of contract. Provide separate categories for annuity contracts, for group life insurance contracts, and for all other life insurance

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4 The provision would include a rule to address the issue of avoidance of the provision through reinsurance transactions, i.e., reinsurance premiums that are not includible in the income of an insurance company that is subject to tax under Subchapter L of the Code (for example, because the reinsurance premiums are payable to a foreign reinsurer not subject to Federal income tax on such premiums).

contracts and noncancellable or guaranteed renewable accident and health insurance contracts. Include reinsurance contracts in each category. Provide an exclusion for contracts entered into under qualified pension plans.

Determine acquisition expenses subject to amortization as percentages of total premiums according to the following schedule:

Group Life	1.65%
Annuities	1.40%
Other Life and Noncancellable or Guaranteed Renewable Accident & Health . .	6.25%

For cancellable accident and health insurance contracts and other similar contracts, reduce the reserves of life insurance companies for unearned premiums and for premiums received in advance by 20 percent, and include in income over a 6-year period 20 percent of such reserves as of the last day of the first taxable year ending on or after September 29, 1990. For noncancellable or guaranteed renewable accident and health insurance contracts, clarify that the reserves of property and casualty insurance companies are to be determined under the present-law rules applicable to life insurance companies. Repeal the special treatment of acquisition expenses of life insurance companies under the adjusted current earnings provision of the corporate alternative minimum tax.

Effective Date

Apply the amortization requirement as of September 30, 1990. For a taxable year that includes September 30, 1990, apply the amortization requirement only with respect to the portion of premiums deemed attributable on a pro-rata basis to the portion of the taxable year that occurs after September 29, 1990. Do not treat the amortization of acquisition costs as a change in a method of accounting. Apply the proposals relating to reserves and the repeal of the treatment of acquisition expenses for purposes of determining adjusted current earnings to taxable years beginning after September 29, 1990.

9. Reimpose the Leaking Underground Storage Tank Trust Fund Tax

Present Law

Prior to September 1, 1990, a tax of 0.1 cent per gallon was imposed on gasoline, diesel fuel, special motor fuels, aviation fuel, and fuels used on inland waterways. These revenues were deposited in the Leaking Underground Storage Tank Trust Fund. The 0.1 cent tax was terminated on August 31, 1990, after the Fund reached a statutory ceiling of $500 million of net revenue. If the ceiling had not been reached, the tax would have expired December 31, 1991.

Summit Agreement

Reimpose the Leaking Underground Storage Tank Trust Fund tax, extend the tax for five years (through December 31, 1995), and eliminate the Trust Fund revenue ceiling.

Effective date.--The proposal is effective on October 1, 1990.

Proposed Amendment

Same as Summit Agreement, except for the effective date.

Effective Date

30 days after the date of enactment.

10. Increase Airport and Airway Trust Fund Excise Taxes

Present Law

Tax rates.--Excise taxes which are imposed for transfer to the Airport and Airway Trust Fund are (1) an 8-percent tax on air passenger transportation, (2) a 5-percent tax on air freight, (3) a $6 per passenger tax on international departures, (4) a tax of 12 cents per gallon on gasoline used in noncommercial aviation, and (5) a tax of 14 cents per gallon on nongasoline (jet) fuels used in noncommercial aviation. These taxes are scheduled to expire after December 31, 1990.

Tax reduction trigger.--Under present law, the aviation excise taxes generally will be reduced by 50 percent (except for the departure tax and the gasoline tax)[5] beginning on January 1, 1991, if the appropriations from the Trust Fund for fiscal years 1989 and 1990 for airport improvements, facilities and equipment, and research, engineering, and development were less than 85 percent of the total amounts authorized for these programs. (The amounts actually appropriated for these programs for fiscal years 1989 and 1990 were 80.7 percent of the amounts authorized.)

Summit Agreement

Extend the current Airport and Airway Trust Fund excise taxes for 5 years (January 1, 1991 through December 31, 1995).

For the same 5-year period, provide additional taxes on the air passengers and air freight of 2 percent and 1.25 percent, respectively. Also, impose additional taxes on noncommercial aviation fuels of 3 cents per gallon for gasoline and to 3.5 cents per gallon for jet fuel. The proposal does not affect the international air departure tax, which was increased to $6 on January 1, 1990. Further, the tax reduction trigger is repealed. Thus, for the 5-year period, 1991-1995, the aviation excise taxes will be 10 percent and 6.25 percent, respectively, for air passengers and air freight, 15 cents per gallon for noncommercial aviation gasoline, 17.5 cents per gallon for noncommercial aviation jet fuels, and $6 per person for international departures.

Revenues from the current aviation tax rates continue to go to the Airport and Airway Trust Fund through 1995.

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[5] The tax on noncommercial aviation gasoline would be reduced from 12 cents to the basic Highway Trust Fund tax rate of 9 cents per gallon on gasoline (under sec. 4081).

Revenues from the proposed increases in tax rates go into the General Fund.

The proposal is effective on January 1, 1991.

The President's fiscal year 1991 budget includes the proposed tax rate increases; however, under the President's budget proposal, the increase in aviation tax revenues would go to the Airport and Airway Trust Fund.

Proposed Amendments

Same as the summit agreement, except for the effective date and that the tax revenues from the proposed increases in tax rates go to the general fund through 1992 and to the Trust Fund for 1993-1995.

Effective Date

Effective on December 1, 1990.

11. Increase the Harbor Maintenance Excise Tax

Present Law

A harbor maintenance tax is imposed on the use of U.S. ports. The tax is 0.04 percent of the value of commercial cargo loaded or unloaded at U.S. ports. The tax generally applies to commercial ship passenger fares, except for certain ferry boats. Revenues from the tax are transferred to the Harbor Maintenance Trust Fund to help pay for Federal harbor maintenance costs.

The tax does not apply to (1) cargo shipped between a U.S. mainland port and Alaska, Hawaii, or a U.S. possession for ultimate use or consumption therein; (2) cargo shipped between Alaska, Hawaii, or a U.S. possession (or between two possessions) for ultimate use or consumption therein; and (3) cargo loaded and unloaded within Alaska, Hawaii, or a U.S. possession. This exception does not apply to cargo destined for foreign consumption or to crude oil cargo with respect to Alaska. The tax also does not apply to cargo donated for foreign use.

Summit Agreement

Increase the harbor maintenance tax to 0.125 percent of the value of commercial cargo or passenger fare.

Effective date

Effective on January 1, 1991.

12. Use of Excess Pension Plan Assets

a. Transfer of excess pension plan assets to pay current retiree health benefits

Present Law

Under present law, pension plan assets may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Any assets that revert to the employer upon such termination are included in the gross income of the employer and are subject to an excise tax (sec. 4980).

Subject to certain limitations, an employer may under present law make deductible contributions to a defined benefit pension plan up to the full funding limitation. The full funding limitation is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan and (b) 150 percent of the plan's current liability, over (2) the lesser of (a) the fair market value of the plan's assets, and (b) the actuarial value of the plan's assets.

Under present law, a pension plan may provide medical benefits to retirees through a section 401(h) account. The assets of a pension plan may not be transferred to a section 401(h) account without disqualifying the pension plan and subjecting the amounts transferred to income tax and the excise tax.

Summit Agreement

Under the summit agreement, annual transfers of excess assets are permitted from the pension assets in a defined benefit pension plan (other than a multiemployer plan) to the section 401(h) account that is a part of such plan. The assets transferred are not includible in the gross income of the employer and are not subject to the excise tax on reversions. The defined benefit pension plan does not fail to satisfy the qualification requirements (sec. 401(a)) solely on account of the transfer and does not violate the present-law requirement that medical benefits under a section 401(h) account be subordinate to the retirement benefits under the plan.

In order to qualify for the tax treatment described above: (1) a transfer of assets to a section 401(h) account may be made only once in any taxable year of the employer and may be made only in taxable years beginning after December 31, 1990, and before January 1, 1996; (2) the transferred assets (and income thereon) are required to be used to pay certain retiree health benefit liabilities; (3) certain vesting requirements must be satisfied; (4) certain minimum benefit requirements must be satisfied; and (5) the amount transferred cannot exceed certain limits. Notice of the transfer must also be provided.

Assets transferred in a qualified transfer (and any income thereon) are required to be used to pay qualified current retiree health liabilities (either directly or through reimbursement) for the taxable year of the transfer. In general, qualified current retiree health liabilities are defined as the amount of retiree health benefits (including administrative expenses) which would have been deductible by the employer with respect to applicable health benefits provided during the taxable year, determined as if the benefits were provided directly by an employer on a cash accounting basis. Retiree health benefits of key employees (sec. 416(i)(1)) may not be paid (directly or indirectly) out of transferred assets. Transferred amounts are generally required to benefit all participants in the pension plan who are entitled upon retirement to receive retiree medical benefits (other than key employees) through the section 401(h) account. Amounts not used to pay qualified retiree health liabilities for the taxable year of the transfer are to be returned at the end of the taxable year to the general assets of the plan. Amounts transferred back are not includible in the gross income of the employer, but are subject to the excise tax on reversions.

In order for the transfer to be qualified, accrued retirement benefits under the pension plan must be nonforfeitable as if the plan terminated on the date of transfer. In addition, the benefits of plan participants who separated from service before the transfer but during the one-year period preceding the transfer also must be nonforfeitable as if the plan terminated immediately before the separation from service.

An employer that makes a transfer to a section 401(h) account under the proposal is to maintain employer-provided retiree health expenditures for covered employees at a minimum dollar level for the taxable year of the transfer and the following 4 taxable years. The minimum level is equal to the highest average employer cost per covered retiree for retiree health benefits for the pension plan participants in the 2 years preceding the year of the transfer. An employer is permitted to apply the minimum benefit requirement under the proposal separately with respect to those covered retirees who are eligible for medicare and those that are not.

The maximum amount of excess assets that may be transferred in a taxable year cannot exceed the amount reasonably estimated to be the amount the employer will pay out of the section 401(h) account during the taxable year for qualified current retiree health liabilities. In determining the amount that may be transferred, the employer is to consider earnings that will be attributable to such assets subsequent to the transfer.

A special rule applies with respect to an employer's taxable year beginning in 1990. Under this rule, an employer may transfer to a section 401(h) account the amount expended by the employer for qualified retiree health benefits during the employer's 1990 taxable year. The transfer may be made after the end of the 1990 taxable year and before the time the employer files its tax return for such year. If an employer transfers assets for 1990 expenses, then additional vesting requirements apply. No deduction is allowed for expenses reimbursed under this rule.

The amount of qualified current retiree health liabilities is generally reduced to the extent that the employer has previously made a contribution to a section 401(h) account or a welfare benefit fund (e.g., voluntary employees' beneficiary association (VEBA)) relating to the same liabilities. The portion of existing reserves in a welfare benefits fund that relate to qualified current retiree health liabilities is determined on a pro-rata basis.

The retired employees who may be taken into account in calculating qualified current retiree health liabilities are limited to those who are eligible for retirement benefits under the defined benefit pension plan containing the separate account and eligible for retiree health benefits (other than key employees).

Under the proposal, excess assets are defined to be the excess of the value of plan assets (calculated as under the full funding limitation) over the greater of (1) the lesser of (a) 150 percent of current liability and (b) the accrued liability under the plan, and (2) 125 percent of current liability. Thus, for example, in the case of a plan subject to the accrued liability full funding limitation, the value of assets remaining in the pension plan following a transfer must be at least the greater of the plan's accrued liability and 125 percent of current liability.

The employer is not entitled to a deduction when amounts are transferred into the section 401(h) account or when such amounts (or income on such amounts) are used to pay retiree health benefits. No deduction or contribution is allowed the employer for the provision of retiree health benefits (whether directly, through a 401(h) account, or a welfare benefit fund) except to the extent that the total of such payments for qualified current retiree health liabilities exceed the amount transferred to the section 401(h) account (including any income thereon). An employer may not contribute after December 31, 1990, any contributions to a health benefits account or a welfare benefit fund with respect to qualified current retiree health liabilities for which transferred assets (and income thereon) are required to be used under the proposal until after such assets (and income) have been totally expended from the account.

For purposes of applying the funding limitations, transferred assets (and income thereon) are required to be taken into account until expended from the section 401(h) account. The transfer is to be treated as a net experience loss for funding purposes, except that the amortization period is 10 years rather than 5 years.

The proposal amends title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA) to require that notice of a proposed transfer be provided to the Secretary of Treasury, the Secretary of Labor, plan participants, and employee representatives (if any) at least 60 days prior to the transfer.

A transfer made in accordance with the provision will not cause a plan to violate title I of ERISA.

Effective Date

The provision is effective for transfers in taxable years beginning after December 31, 1990.

b. Reversions of excess pension assets

Present Law

Under present law, pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Any assets that revert to the employer upon such termination are includible in the gross income of the employer and subject to a 15-percent excise tax (sec. 4980).

Summit Agreement

In general, the summit agreement increases the excise tax on reversions from 15 percent to 20 percent. In the case of an employer that does not establish or maintain a qualified replacement plan in connection with a plan termination, the reversion excise tax is 40 percent of the amount of the reversion.

A qualified replacement plan is a qualified plan maintained by the employer which meets the following requirements: (1) substantially all of the participants or beneficiaries in the terminated plan are participants or their beneficiaries under the replacement plan; (2) assets equal to 20 percent of the amount of the reversion are transferred directly from the terminated plan to the replacement plan; and (3) in the case of a replacement plan that is a defined contribution plan, the transferred assets (and income thereon) are allocated to participants and beneficiaries no less rapidly than ratably over a period not to exceed 7 years (including the year of the transfer). Transferred assets (and income thereon) are treated as employer contributions when allocated to participant accounts for purposes of the limits on contributions and benefits (sec. 415).

If the employer provides certain pro rata benefit increases to plan participants as part of the plan termination transaction, then the required cushion is reduced from 20 percent to 15 percent. In order for this reduction in the asset cushion to apply, the nonforfeitable accrued benefits of the participants and beneficiaries under the terminating plan (including those in pay status) must be increased effective as of the termination date so that the total present value of increased benefits (determined on a termination basis) is equal to 15 percent of the employer reversion (determined without regard to the asset transfer provision). In no event can the aggregate increase in the nonforfeitable accrued benefits of persons in pay status as of the termination date exceed 40 percent of the total benefit increase (i.e., 6 percent of the reversion determined without regard to the asset transfer provision). Benefit increases that would exceed this amount are to be allocated among other plan participants on a pro rata basis.

The present value of other benefit increases occurring during the 60-day period before the plan termination reduces the 20 percent cushion on a dollar for dollar basis.

All benefit increases and allocations of transferred assets are subject to the limitations on contributions and benefits (sec. 415) and the nondiscrimination rules (sec. 401(a)(4)).

Amounts transferred to a qualified replacement plan are not includible in the gross income of the employer and are not subject to the excise tax on reversions. The employer is not entitled to a deduction for amounts transferred to a qualified replacement plan.

In the case of an employer that is in bankruptcy liquidation under chapter 7 of title 11 of the United States Code or in liquidation under similar proceedings under State law, the amount of the excise tax in all cases is 20 percent.

If the employer chooses to reduce the applicable excise tax through an asset transfer, the transfer is subject to the fiduciary rules of title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

Effective date.--The summit agreement applies to reversions occurring after September 30, 1990, other than (1) in the case of plans subject to title IV of ERISA, reversions pursuant to a termination, notice of which was provided under such title to participants (or if no participants, the Pension Benefit Guaranty Corporation) on or before such date, and (2) in the case of plans not subject to title IV of ERISA, but subject to title I, a notice of intent to reduce future benefit accruals was provided to plan participants on or before such date.

Proposed Amendments

Same as the summit agreement, except that the amount of the cushion is increased from 20 percent to 30 percent, and the amount of the excise tax if there is no transfer of assets to a qualified replacement plan is 50 percent. In addition, the 30 percent required cushion is reduced to 25 percent if the employer provides pro rata benefit increases to plan participants and beneficiaries (including those in pay status) under the terminating plan as under the summit agreement. As under the summit agreement, the total amount of benefit increases to participants in pay status cannot exceed 40 percent of the total benefit increase (i.e., 10 percent of the reversion determined without regard to the cushion provision).

The following example illustrates the modification of the excise tax under the proposed amendment. Assume that Employer A terminates a defined benefit pension plan and that, after satisfaction of all plan liabilities, the remaining assets in the plan are $100x. $30x is transferred to a defined contribution plan of the employer that qualifies as a qualified replacement plan. No benefit increases are provided in connection with the plan termination. The $30x transferred to the qualified replacement plan is not includible in the gross income of the employer nor subject to the reversion excise tax. The employer is liable for an excise tax of $14x [.20 x ($100x - $30x)], and $70x is includible in the gross income of the employer.

<u>Effective Date</u>

Same as the Summit Agreement.

13. Coverage of State and Local Government Employees Under Medicare

Present Law

Before enactment of the Consolidated Omnibus Reconciliation Act of 1985 (COBRA), State and local workers were covered under Medicare only if the State and the Secretary of Health and Human Services entered into a voluntary agreement providing such coverage. In COBRA, the Congress extended Medicare coverage (and the corresponding hospital insurance payroll tax) on a mandatory basis to State and local government employees (other than students) hired after March 31, 1986.

For wages paid in 1990 to Medicare-covered employees, the total hospital insurance tax rate is 2.9 percent of the first $51,300 of wages. The tax is divided equally between the employer and the employee.

Summit Agreement

The proposal would require coverage of all employees of State and local governments under Medicare. The 1.45 percent HI payroll tax rate would be phased in for State and local government employers and employees so that the tax is 0.8 percent in 1992; 1.35 percent in 1993; and 1.45 percent in 1994 and thereafter.

Current employees who are required to pay the HI tax as a result of this provision and who are employed by a State or local government as of December 31, 1990, have their prior State and local service deemed to have been covered by the HI tax for purposes of determining Medicare eligibility. Prior State and local service is counted regardless of whether such service was continuous. The Secretary of Health and Human Services is required to provide a process by which employees could provide evidence of prior State and local governmental service if such service is necessary to qualify for coverage under the program.

Effective Date

Effective with respect to services performed after December 31, 1991.

14. Deny Deduction for Certain Interest Paid on Corporate Federal Tax Underpayments

Present Law

In general, corporations are allowed an income tax deduction for all interest paid or accrued, including interest on tax obligations.

Individuals, under present law, are not permitted to deduct personal interest. For this purpose, personal interest includes interest on underpayments of personal income taxes, even if all or a portion of the individual's income is attributable to a trade or business.

Summit Agreement

Deny a deduction for interest economically accruing after December 31, 1990, that is paid by a corporation to the IRS on underpayments relating to any type of Federal tax. Thus, if a corporation filed a return in 1988, was assessed additional tax by the IRS in 1991, and pays those amounts in full in 1992, the corporation may deduct the interest economically accruing with respect to the period 1987 through 1990, but may not deduct the interest economically accruing after 1990. This rule applies regardless of whether the corporation is on a cash basis or accrual basis, or when the interest is paid or deemed paid. The present-law procedures (described in Rev. Proc. 84-58, as modified by IR 86-144 and IR 86-154) permitting a taxpayer to make a payment of contested tax and interest thereon after a deficiency notice has been provided, while continuing to contest the asserted deficiency in Tax Court, would not be changed.

Effective Date

Effective for interest economically accruing on or after January 1, 1991, regardless of the taxable period (if any) to which the underlying tax may relate.

15. Certain Business Tax Provisions

a. Expand and clarify reporting and allocation rules for asset acquisitions

Present Law

Reporting and allocation rules contained in section 1060 of the Internal Revenue Code are intended to limit the potential for purchasers of a business to claim excessive deductions by allocating excessive amounts of the purchase price to depreciable assets. The reporting rules also provide some limit on possible "whipsaw" of the IRS that might occur if the buyer and seller inconsistently allocate different amounts to the same assets, to the extent the tax law may provide differential treatment for certain items.

Summit Agreement

The summit agreement provides for the inclusion of certain revisions in business tax provisions as may be mutually agreed upon.

Proposed Implementation of Summit Agreement

Clarify that reporting rules apply to all stock acquisitions that are treated as asset acquisitions for tax purposes.

In addition, expand the reporting rules to cases where a 10-percent or greater shareholder of a corporation transfers nondepreciable stock of such corporation and, in connection with such transfer, enters into a covenant not to compete, lease or other agreement with the transferee. In such cases, reporting would be required with respect to the amounts allocated to the stock and to the agreement.

Finally, if there is a written agreement between the parties as to the allocation of purchase price to particular items, neither party would be able to take a contrary position for tax purposes. The IRS, however, would retain the ability to challenge any allocation to the same extent as under present law.

Effective Date

Effective for acquisitions on or after October 10, 1990, unless pursuant to a binding written contract in effect before and on that date and at all times thereafter until the acquisition.

b. Require accrual of redemption premium of certain preferred stock

Present Law

A preferred stockholder is deemed to receive constructive distributions with respect to preferred stock if the redemption price of such stock exceeds its issue price by more than a reasonable redemption premium. A redemption premium is considered to be reasonable if it is in the nature of a penalty for a premature redemption and if such premium is not in excess of the amount the corporation would be required to pay for the right to make such premature redemption under market conditions existing at the time of issuance. In addition, a redemption premium not in excess of 10 percent of the issue price of stock which is not redeemable for 5 years from the date of issue is considered to be reasonable (Treas. Reg. sec. 1.305-5(b)(2)).

If a preferred stock is considered to have an unreasonable redemption premium, the portion of the premium that is considered to be unreasonable is deemed to be distributed to the preferred stockholder ratably over the time during which such stock cannot be called for redemption. Thus, if a preferred stock issued with an unreasonable redemption premium is callable throughout its term, no part of the premium is included in the holder's income until redemption.

If a debt instrument is issued with a stated redemption price at maturity in excess of its issue price, such instrument is considered to be issued with original issue discount (OID). An instrument is not considered to have OID if the stated redemption price at maturity of the instrument exceeds its issue price by an amount that is less than the product of: (1) one-quarter of one percent of the stated redemption price and (2) the number of complete years to maturity. The holder of an OID instrument includes the amount of OID in gross income over the term of the instrument on an economic accrual basis.

Summit Agreement

The summit agreement provides for the inclusion of certain revisions in business tax provisions as may be mutually agreed upon.

Proposed Implementation of Summit Agreement

Require holders of certain preferred stock to treat the entire amount of a redemption premium of such stock as being distributed over the period that the stock is outstanding in a manner consistent with rules applicable to holders of OID instruments (i.e., both the OID economic accrual and de minimis rules apply). The proposal applies to preferred stock that is subject to a mandatory redemption or is puttable by the holder (regardless of whether such stock is also callable by the issuer).

In addition, the proposal applies to the redemption premium of preferred stock that is callable by the issuer to the extent the premium is not considered reasonable under present law.

Effective Date

Effective for stock issued on or after October 10, 1990, unless issued pursuant to a binding written contract in effect before and on that date and all times thereafter until such issuance, or pursuant to an SEC or similar state registration statement filed before such date and the stock is issued within 90 days of the filing.

c. Expand the definition of a corporate equity reduction transaction for purposes of limiting certain NOL carrybacks

Present Law

The ability of a C corporation to obtain refunds of taxes paid in prior years by carrying back net operating losses (NOLs) is limited in cases where the losses are created by interest deductions allocable to a corporate equity reduction transaction ("CERT"). A CERT includes the acquisition of 50 percent or more of the vote or value of the stock of another corporation. However, a CERT does not include the acquisition of the stock of another corporation (1) that, immediately before the acquisition, was a subsidiary of an affiliated group, or (2) with respect to which an election under section 338 was made to treat the stock acquisition as an asset acquisition.

Summit Agreement

The summit agreement provides for the inclusion of certain revisions in business tax provisions as may be mutually agreed upon.

Proposed Implementation of Summit Agreement

Expand the definition of a CERT to include the acquisition of 50 percent or more of the stock of any corporation regardless of whether the corporation was a member of an affiliated group (unless an election under section 338 was made to treat the acquisition as an acquisition of assets).

Effective Date

Effective for acquisitions on or after October 10, 1990, unless pursuant to a binding written contract in effect before and on such date and at all times thereafter until such acquisition.

d. Impose corporate tax on divisive transactions in connection with certain changes of ownership

Present Law

Distributions of stock of a subsidiary in certain divisive transactions governed by section 355 are tax-free to both the distributing corporation and to the shareholders who receive the stock distributed.

A distribution generally is tax-free under section 355 provided certain statutory requirements are met, including: (1) the transaction is not used as a device for the distribution of earnings and profits; (2) the distributing corporation and the controlled corporation each are engaged immediately after the distribution in the active conduct of a trade or business, and meet certain 5-year requirements regarding the active conduct of the business before the transaction; (3) all of the controlled corporation's stock is distributed, or at least 80 percent is distributed and the retention of the balance does not have as a principal purpose the avoidance of Federal income tax; and (4) the shareholders have continuity of proprietary interest after the transaction.

The recipient shareholders in a tax-free divisive transaction apportion the basis in the stock of the distributing corporation that they held prior to the distribution between the new subsidiary stock received and any stock of the distributing corporation that they retain. As a result, a shareholder that has recently purchased stock of the distributing corporation may obtain a fair market value basis in the stock of any subsidiary that is distributed shortly thereafter in a section 355 transaction.

In order to qualify for tax-free treatment, the distribution is not required to be pro-rata to all shareholders. The receiving shareholders in a non-pro-rata distribution normally surrender stock of the distributing corporation equal in value to the stock they receive in the distribution.

Present law imposes a 5-year holding period requirement for any corporate stockholder that has acquired 80 percent of the stock of an acquired ("target") corporation, unless the stock was acquired solely in nontaxable transactions. If the 5-year holding period is not met, distributions of lower-tier subsidiaries from the target corporation to its new corporate stockholder cannot be tax-free under section 355.

Summit Agreement

The summit agreement provides for the inclusion of certain revisions in business tax provisions as may be mutually agreed upon.

Proposed Implementation of Summit Agreement

Subject a corporation that distributes a subsidiary in an otherwise tax-free divisive transaction to corporate-level tax if the transaction resembles a sale. Specifically, the transaction is taxable at the corporate level if, after the distribution, a shareholder holds at least 50 percent of the stock of a corporation involved in the transaction (generally, the distributing corporation or the distributed subsidiary), provided that the shareholder's 50-percent ownership is attributable to stock the shareholder acquired directly or indirectly in a purchase or certain similar transactions within the previous five years.

Effective Date

Effective for distributions on or after October 10, 1990, but only where stock is acquired on or after October 10, 1990. Stock acquired pursuant to a binding written contract to acquire such stock or tender offer in effect before and on such date and at all times thereafter until the acquisition is treated as acquired before October 10, 1990.

e. Clarify treatment of debt exchanges

Present Law

Income from the cancellation of indebtedness

In general.-- Gross income includes income from the cancellation of indebtedness (COD). Taxpayers in title 11 cases and insolvent debtors generally exclude COD from income but reduce tax attributes by the amount of COD created on the discharge of debt. The amount of COD excluded from income by an insolvent debtor not in title 11 cannot exceed the amount by which the debtor is insolvent. For all taxpayers, the amount of COD generally is the difference between the amount of the debt being cancelled and the amount used to satisfy such debt. The COD rules generally apply to the exchange of an old obligation for a new obligation (a debt-for-debt exchange).

Treatment of stock-for-debt exchanges.--For purposes of determining COD, if a debtor corporation transfers stock to a creditor in satisfaction of debt, the corporation is treated as having satisfied the debt with an amount of money equal to the fair market value of the stock. However, taxpayers in title 11 cases and insolvent debtors generally may issue stock in satisfaction of debt without creating COD (the stock-for-debt exception).[6]

Original issue discount rules

Original issue discount (OID) generally is the excess of the stated redemption price at maturity over the issue price of a debt instrument. For purposes of the OID rules, the issue price of a debt instrument that is publicly traded, or that is issued for property that is publicly traded, generally is determined by reference to fair market value. (Sec. 1273(b)). If neither the debt instrument nor the property for which it is issued is publicly traded, the issue price of the instrument is its stated principal amount, provided the instrument has adequate stated interest. If the debt instrument lacks adequate stated interest, the issue price of the instrument is determined by using the applicable Federal rate to discount the instrument's stated principal amount. (Sec. 1274). Finally, for debt-for-debt exchanges in a reorganization, the issue price of a new debt instrument is not less than the adjusted issue price of the old debt instrument. (Sec. 1275(a)(4)).

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6 The IRS has recently published a ruling that provides that the stock-for-debt exception can apply only to the extent of the redemption price and liquidation preference of preferred stock issued for debt. (Rev. Rul. 90-87, issued October 2, 1990).

Taxpayers take various positions as to whether and how these OID and other rules apply for purposes of determining COD.

Summit Agreement

The summit agreement provides for the inclusion of certain revisions in business tax provisions as may be mutually agreed upon.

Proposed Implementation of Summit Agreement

Debt-for-debt exchanges

Provide explicit rules for determining the amount of COD created in a debt-for-debt exchange and clarify how the OID rules apply in such a situation. No inference is intended as the proper treatment of debt-for-debt exchanges under present law. Under the provision, the amount of COD will be the amount that the adjusted issue price of the old obligation exceeds the issue price of the new obligation. For this purpose, the issue price of the new obligation will be determined under the general rules applicable to instruments issued with OID (i.e., secs. 1273 and 1274). In addition, the reorganization exception in section 1275(a)(4) of the OID rules is repealed.

Thus, if either the old or the new obligation in a debt-for-debt exchange is publicly traded, the issue price of the new obligation will be the fair market value of the publicly-traded obligation. If neither obligation is publicly traded, the issue price of the new obligation will be its stated principal amount, unless the new obligation does not have adequate stated interest. In such case, the issue price is determined by using the applicable Federal rate to discount the stated principal amount of the new obligation.

Stock-for-debt exchanges

In addition, repeal the stock-for-debt exception for title 11 cases and insolvent debtors for taxpayers that issue certain preferred stock in exchange for debt. The provision applies to preferred stock that resembles debt; such stock includes preferred stock that has a stated redemption price and that either is subject to a fixed maturity date, is callable by the issuer, or is puttable by the holder.

Thus, under the provision, taxpayers in title 11 cases or insolvent taxpayers will reduce their tax attributes by the amount that the amount of debt discharged exceeds the fair market value of certain preferred stock issued in discharge thereof. In the case of an insolvent taxpayer not in title 11, the amount of COD in excess of the amount of insolvency, if any, will be included in gross income in accordance with present-law rules.

Effective Date

Effective generally for debt-for-debt or stock-for-debt exchanges occurring on or after October 10, 1990. The provision does not apply to an exchange pursuant to a binding written contract or a tender offer filed with the Securities and Exchange Commission, in effect before October 10, 1990, and all times thereafter. In addition, the provision does not apply to an exchange resulting from a proceeding in a title 11 or similar case that had been filed before October 10, 1990.

16. Limitation on Itemized Deductions

Present Law

Under present law, individuals who do not elect the standard deduction may claim itemized deductions (subject to certain limitations) for certain nonbusiness expenses incurred during the taxable year. Among these deductible expenses are unreimbursed medical expenses, casualty and theft losses, charitable contributions, qualified residence interest, a portion of personal interest (10 percent in 1990; zero thereafter), State and local income and property taxes, moving expenses, unreimbursed employee business expenses, and certain other miscellaneous expenses.

Certain itemized deductions are allowed only to the extent that the amount of the expense incurred during the taxable year exceeds a specified percentage of the taxpayer's adjusted gross income (AGI). Unreimbursed medical expenses for care of the taxpayer and the taxpayer's spouse and dependents are deductible only to the extent that the total of such expenses exceeds 7.5 percent of the taxpayer's AGI. Nonbusiness casualty or theft losses are deductible only to the extent that the amount of the loss arising from each casualty or theft exceeds $100 and only to the extent that total casualty and theft losses exceed 10 percent of the taxpayer's AGI. Unreimbursed employee business expenses and certain other miscellaneous itemized deductions are deductible only to the extent that the total of such expenses and deductions exceeds two percent of the taxpayer's AGI.

Summit Agreement

Reduce total otherwise allowable itemized deductions (other than medical expenses and investment interest) by an amount equal to three percent of the amount of a taxpayer's AGI in excess of $100,000. In no event, however, would total otherwise allowable itemized deductions (excluding medical expenses and investment interest) be reduced by more than 80 percent.

In computing the amount of the reduction of total itemized deductions under the proposal, all present-law limitations applicable to such deductions first would be applied and the otherwise allowable total amount of deductions would then be reduced pursuant to the proposal. An appropriate adjustment would be provided for alternative minimum tax (AMT) purposes. For purposes of determining the tax treatment of State income tax refunds and other similar payments, the present-law tax benefit rule would apply.

For example, a taxpayer with AGI of $250,000 and $90,000 of otherwise allowable itemized deductions ($20,000 of which are medical expenses and investment interest) would have itemized deductions reduced by $4,500 (3% X ($250,000 - $100,000)). If such a taxpayer's AGI increased above $1,966,667 and itemized deductions remained the same, the taxpayer would still be able to deduct a total of $14,000 of itemized deductions other than medical expenses and investment interest (($90,000 - $20,000) - (80% X $70,000)).

Effective Date

Effective for taxable years beginning after December 31, 1990.

17. Increase Cap on Wages and Self-Employment Income Subject to the Medicare Hospital Insurance Payroll Tax

Present Law

As part of the Federal Insurance Contributions Act (FICA), a tax is imposed on employees and employers up to a maximum amount of employee wages. The tax is comprised of two parts: old-age, survivor, and disability insurance (OASDI) and Medicare hospital insurance (HI). For wages paid in 1990 to covered employees, the HI tax rate is 1.45 percent on both the employer and the employee on the first $51,300 of wages and the OASDI tax rate is 6.2 percent on both the employer and the employee on the first $51,300 of wages.

Under the Self-Employment Contributions Act of 1954 (SECA), a tax is imposed on an individual's self-employment income. The self-employment tax rate is the same as the total rate for employers and employees (i.e., 2.9 percent for HI and 12.40 percent for OASDI). For 1990, the tax is applied to the first $51,300 of self-employment income and, in general, the tax is reduced by any wages for which employment taxes were withheld during the year.

The wage cap is indexed to changes in the average wages in the economy. In 1991, the amount of wages or self-employment income subject to the tax is projected to be $54,300.

Summit Agreement

Under the summit agreement, the cap on wages and self-employment income considered in calculating the tax liability for the Medicare hospital insurance (HI) is increased to $73,000. As under present law, the wage cap is indexed to changes in the average wages in the economy. The OASDI wage cap remains at the level provided under present law.

Effective Date

Effective on January 1, 1991.

18. Extend Social Security Retirement Coverage (OASDI) to State and Local Government Employees Not Covered by a Public Employee Retirement Program

Present Law

Employees of State and local governments are covered under social security by voluntary agreements entered into by the States with the Secretary of Health and Human Services (HHS). After a State has entered into an agreement, it may decide, or permit its political subdivisions to decide, whether to include particular groups of employees under the agreement. All States have entered into such agreements. The extent of coverage is high in some States and limited in others. Nationally, about 72 percent of State and local workers are covered by social security.

With certain exceptions, the State has broad latitude to decide which groups of State and local employees are covered under its agreement. In some cases where States have elected not to provide coverage, a part of their workforce does not participate in any public retirement plan. Most of these individuals are temporary workers, part-time workers, and students employed by State universities.

For 1990, the social security (Old Age, Survivors, and Disability Insurance) tax rate is 6.2 percent of covered wages up to $51,300 and is imposed on both the employer and employee.

Summit Agreement

The summit agreement requires social security (Old Age, Survivors, and Disability Insurance) coverage for State and local workers who are not covered by a retirement system in conjunction with their employment for the State or local government. A retirement system is defined as under the Social Security Act (42 U.S.C. 418(b)(4)).

Effective Date

Effective with respect to services performed after September 30, 1990.

19. Increase in Railroad Retirement Tier 2 payroll taxes

Present Law

Railroad employers, employees and employee representatives are subject to a payroll tax to fund Tier 2 railroad retirement benefits. The tax rate is 4.90 percent for employees, 16.10 percent for employers, and 14.75 percent for employee representatives. In 1990, the tax is imposed on wages up to a maximum of $38,100. In 1991, this wage base is projected to increase to $40,500.

Summit Agreement

The agreement assumes an increase in the Tier 2 tax rate of .40 percent on the Tier 2 wage base (capped at $38,100 in 1990). In the alternative, the rate would be recalculated at current rates, but would attribute employer contributions on a rolling 10-year base to account for the reduced number of rail employees and thus greatly reduced contributions by some railroads.

Effective Date

Effective on January 1, 1991.

20. Payroll Tax Deposit Stabilization

Present Law

Treasury regulations have established the system under which employers deposit income taxes withheld from employees' wages and FICA taxes. The frequency with which these taxes must be deposited increases as the amount required to be deposited increases.

Employers are required to deposit these taxes as frequently as eight times per month, provided that the amount to be deposited equals or exceeds $3,000. These deposits must be made within three banking days after the end of the eighth-monthly period.

Effective August 1, 1990, employers who are on this eighth-monthly system are required to deposit income taxes withheld from employees' wages and FICA taxes by the close of the applicable banking day (instead of by the close of the third banking day) after any day on which the business cumulates an amount to be deposited equal to or greater than $100,000 (regardless of whether that day is the last day of an eighth-monthly period).

For 1990, the applicable banking day is the first. Under present law, for 1991, the applicable banking day is the second. Under present law, for 1992, the applicable banking day is the third. Under present law, for 1993 and 1994, the applicable banking day is the first.

Summit Agreement

Require that deposits equal to or greater than $100,000 must be made by the close of the next banking day for all years. Thus, no change from present law would be necessary for calendar year 1990, but for calendar years 1991 and 1992 deposits would be accelerated.

Effective Date

Effective for amounts required to be deposited after December 31, 1990.