DESCRIPTION OF AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO THE CHAIRMAN'S MARK RELATING TO EXTENSION OF CERTAIN EXPIRING TAX PROVISIONS

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CONTENTS

Page

INTRODUCTION 1

I. PROVISIONS EXTENDED THROUGH DECEMBER 31, 1997 2

A. Work Opportunity Tax Credit 2

B. Employer-Provided Educational Assistance 12

C. Research and Development Tax Credit 14

D. Contributions of Appreciated Stock to Private Foundations . 19

E. Orphan Drug Tax Credit 21

II. PERMANENT EXTENSION OF FUTA EXEMPTION FOR ALIEN AGRICULTURAL WORKERS 22

III. TRANSPORTATION FUELS TAX EXEMPTION FOR FUELS USED IN COMMERCIAL AVIATION 23

IV. EXTENSION OF AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES 25

INTRODUCTION

The House Committee on Ways and Means has scheduled a markup of various revenue provisions beginning on September 18, 1995. This document, prepared by the staff of the Joint Committee on Taxation, provides a description of present law and the proposed extension of certain expiring tax provisions.[1]

Part I contains a description of expiring tax provisions extended through December 31, 1997; Part II describes the permanent extension of the FUTA exemption for alien agricultural workers; Part III describes the extension of the exemption for commercial aviation fuel; and Part IV describes the extension of the Airport and Airway Trust Fund excise taxes.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of an Amendment in the Nature of a Substitute to the Chairman's Mark Relating to Extension of Certain Expiring Tax Provisions* (JCX-33-95), September 18, 1995.

I. PROVISIONS EXTENDED THROUGH DECEMBER 31, 1997

A. Work Opportunity Tax Credit

Prior Law

General rules

Prior to January 1, 1995, the targeted jobs tax credit was available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The credit generally was equal to 40 percent of qualified first-year wages. Qualified first-year wages consisted of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. For a vocational rehabilitation referral, however, the period began the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan.

No more than $6,000 of wages during the first year of employment were permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual was $2,400.

With respect to economically disadvantaged summer youth employees, the credit was equal to 40 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,200.

The deduction for wages was reduced by the amount of the credit.

Certification of members of targeted groups

In general, an individual was not treated as a member of a targeted group unless certification that the individual was a member of such a group was received or requested in writing by the employer from the designated local agency on or before the day on which the individual began work for the employer. In the case of a certification of an economically disadvantaged youth participating in a cooperative education program, this requirement was satisfied if the certification was requested or received from the participating school on or before the day on which the individual began work for the employer. The "designated local agency" was the State employment security agency.

If a certification was incorrect because it was based on false information provided as to the employee's membership in a targeted group, the certification was revoked. Wages paid after the revocation notice was received by the employer were not treated as qualified wages.

The U.S. Employment Service, in consultation with the Internal Revenue Service, was directed to take whatever steps necessary to keep employers informed of the availability of the credit.

Targeted groups eligible for the credit

The nine groups eligible for the credit were either recipients of payments under means-tested transfer programs, economically disadvantaged (as measured by family income), or disabled individuals.

(1) Vocational rehabilitation referrals

Vocational rehabilitation referrals were those individuals who had a physical or mental disability that constituted a substantial handicap to employment and who had been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973, or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification was provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee had met the above conditions.

(2) Economically disadvantaged youths

Economically disadvantaged youths were individuals certified by the designated local employment agency as (1) members of economically disadvantaged families and (2) at least age 18 but not age 23 on the date they were hired by the employer. An individual was determined to be a member of an economically disadvantaged family if, during the six months immediately preceding the earlier of the month in which the determination occurred or the month in which the hiring date occurred, the individual's family income was, on an annual basis, not more than 70 percent of the Bureau of Labor Statistics' lower living standard. A determination that an individual was a member of an economically disadvantaged family was valid for 45 days from the date on which the determination was made.

Except as otherwise noted below, a determination of whether an individual was a member of an economically disadvantaged family was made on the same basis and was subject to the same 45-day limitation, where required in connection with the four other targeted groups that excluded individuals who were not economically disadvantaged.

(3) Economically disadvantaged Vietnam-era veterans

The third targeted group was Vietnam-era veterans certified by the designated local employment agency as members of economically disadvantaged families. For these purposes, a Vietnam-era veteran was an individual who had served on active duty (other than for training) in the Armed Forces for more than 180 days, or who had been discharged or released from active duty in the Armed Forces for a service-connected disability, but in either case, the active duty must have taken place after August 4, 1964, and before May 8, 1975. However, any individual who had served for a period of more than 90 days during which the individual was on active duty

(other than for training) was not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule was intended to prevent employers who hired current members of the armed services (or those departed from service within the last 60-days) from receiving the credit.

(4) SSI recipients

The fourth targeted group was individuals receiving either Supplemental Security Income ("SSI") under Title XVI of the Social Security Act or State supplements described in section 1616 of that Act or section 212 of P.L. 93-66. To be an eligible employee, the individual must have received SSI payments during at least a one-month period ending during the 60-day period that ended on the date the individual was hired by the employer. The designated local agency was to issue the certification after a determination by the agency making the payments that these conditions had been fulfilled.

(5) General assistance recipients

General assistance recipients were individuals who received general assistance for a period of not less than 30 days if that period ended within the 60-day period ending on the date the individual was hired by the employer. General assistance programs were State and local programs that provided individuals with money payments, vouchers, or scrip based on need. These programs were referred to by a wide variety of names, including home relief, poor relief, temporary relief, and direct relief. Because of the wide variety of such programs, Congress provided that a recipient was an eligible employee only after the program had been designated by the Secretary of the Treasury as a program that provided money payments, vouchers, or scrip to needy individuals. Certification was performed by the designated local agency.

(6) Economically disadvantaged former convicts

The sixth targeted group included any individual who was certified by the designated local employment agency as (1) having at some time been convicted of a felony under State or Federal law, (2) being a member of an economically disadvantaged family, and (3) having been hired within five years of the later of release from prison or date of conviction.

(7) Economically disadvantaged cooperative education students

The seventh targeted group was youths who (1) actively participated in qualified cooperative education programs, (2) had attained age 16 but had not attained age 20, (3) had not graduated from high school or vocational school, and (4) were members of economically disadvantaged families. The definitions of a qualified cooperative education program and a qualified school were similar to those used in the Vocational Education Act of 1963. Thus, a qualified cooperative education program meant a program of vocational education for individuals who, through written cooperative arrangements between a qualified school and one or more

employers, received instruction, including required academic instruction, by alternation of study in school with a job in any occupational field, but only if these two experiences were planned and supervised by the school and the employer so that each experience contributed to the student's education and employability.

For this purpose, a qualified school was (1) a specialized high school used exclusively or principally for the provision of vocational education to individuals who were available for study in preparation for entering the labor market, (2) the department of a high school used exclusively or principally for providing vocational education to individuals who were available for study in preparation for entering the labor market, or (3) a technical or vocational school used exclusively or principally for the provision of vocational education to individuals who had completed or left high school and who were available for study in preparation for entering the labor market. In order for a nonpublic school to be a qualified school, it must have been exempt from income tax under section 501(a) of the Code.

The certification was performed by the school participating in the cooperative education program. After initial certification, an individual remained a member of the targeted group only while meeting the program participation, age, and degree status requirements of (a), (b), and (c), above.

(8) AFDC recipients

The eighth targeted group included any individual who was certified by the designated local employment agency as being eligible for Aid to Families with Dependent Children ("AFDC") and as having continually received such aid during the 90 days before being hired by the employer.

(9) Economically disadvantaged summer youth employees

The ninth targeted group included youths who performed services during any 90-day period between May 1 and September 15 of a given year and who were certified by the designated local agency as (1) being 16 or 17 years of age on the hiring date and (2) a member of an economically disadvantaged family. A youth must not have been an employee of the employer prior to that 90-day period. With respect to any particular employer, an employee could qualify only one time for this summer youth credit. If, after the end of the 90-day period, the employer continued to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages took into account wages paid to the youth while a qualified summer youth employee.

Definition of wages

In general, wages eligible for the credit were defined by reference to the definition of wages under the Federal Unemployment Tax Act (FUTA) in section 3306(b) of the Code, except that the dollar limits did not apply. Because wages paid to economically disadvantaged

cooperative education students and to certain agricultural and railroad employees were not FUTA wages, special rules were provided for these wages.

Wages were taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee were for services in the employer's trade or business. The test as to whether more than one-half of an employee's wages were for services in a trade or business was applied to each separate employer without treating related employers as a single employer.

Other rules

In order to prevent taxpayers from eliminating all tax liability by reason of the credit, the amount of the credit could not exceed 90 percent of the taxpayer's income tax liability. Furthermore, the credit was allowed only after certain other nonrefundable credits had been taken. If, after applying these other credits, 90 percent of an employer's remaining tax liability for the year was less than the targeted jobs tax credit, the excess credit could be carried back three years and carried forward 15 years.

All employees of all corporations that were members of a controlled group of corporations were to be treated as if they were employees of the same corporation for purposes of determining the years of employment of any employee and wages for any employee up to $6,000. Generally, under the controlled group rules, the credit allowed the group was the same as if the group were a single company. A comparable rule was provided in the case of partnerships, sole proprietorships, and other trades or businesses (whether or not incorporated) that were under common control, so that all employees of such organizations generally were to be treated as if they were employed by a single person. The amount of targeted jobs tax credit allowable to each member of the controlled group was its proportionate share of the wages giving rise to the credit.

No credit was available for the hiring of certain related individuals (primarily dependents or owners of the taxpayer). The credit was also not available for wages paid to an individual who was employed by the employer at any time during which the individual was not a certified member of a targeted group.

No credit was allowed for wages paid unless the eligible individual was either (1) employed by the employer for at least 90 days (14 days in the case of economically disadvantaged summer youth employees) or (2) had completed at least 120 hours (20 hours for summer youth) of services performed for the employer.

Description of Proposal

General rules

The proposal would replace the targeted jobs tax credit with the "work opportunity tax

credit." The work opportunity tax credit would be available on an elective basis for employers hiring individuals from one or more of five targeted groups. The credit generally would be available equal to 25 percent of qualified wages. Qualified wages would consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer. For a vocational rehabilitation referral, however, the period would begin on the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan as under prior law.

No more than $6,000 of wages during the first year of employment would be permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual would be $1,500.

With respect to qualified summer youth employees, the maximum credit would be one-sixth of up to $3,000 of qualified first-year wages, for a maximum credit of $750.

The deduction for wages would be reduced by the amount of the credit.

Certification of members of targeted groups

In general, an individual would not be treated as a member of a targeted group unless: (1) on or before the day the individual begins work for the employer the employer, received in writing a certification from the designated local agency that the individual is a member of a specific targeted group, or (2) on or before the day the individual is offered work for the employer, a pre-screening notice is completed with respect to that individual and within 14 days after the individual begins work for the employer, the employer submits such notice to the designated local agency as part of a written request for certification. The pre-screening notice would contain the information provided to the employer by the individual which forms the basis of the employer's belief that the individual is a member of a targeted group.

If a certification is incorrect because it is based on false information provided as to the individual's membership in a targeted group, the certification would be revoked. No credit would be allowed on wages paid after receipt by the employer of the revocation notice.

If a designated local agency rejects a certification request it would have to provide a written explanation of the basis of the rejection.

Targeted groups eligible for the credit

(1) Aid to Families with Dependent Children ("AFDC")

An AFDC recipient would be an individual certified as receiving assistance under a State plan approved under part A of title IV of the Social Security Act at any time during the 9-month

period (12 months in the case of certain veterans) ending on the hiring date. Further, such individual must have been receiving such assistance for a period of at least nine months. For these purposes, each member of the family receiving AFDC would be treated as receiving such assistance. A veteran would be an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days, or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(2) Qualified ex-felon

A qualified ex-felon would be an individual certified as: (1) having been convicted of a felony under any State or Federal law; (2) being a member of a family which had an income during the six months before the earlier of the date of determination or the hiring date which on an annual basis is 70 percent or less of the Bureau of Labor Statistics lower living standard; and (3) having a hiring date within one year of release from prison or date of conviction.

(3) High-risk-youth

A high-risk youth would be an individual certified as being at least 18 but not 25 on the hiring date and as having a principal place of abode within an empowerment zone or enterprise community. Qualified wages would not include wages paid or incurred for services performed after the individual moves outside an empowerment zone or enterprise community.

(4) Vocational rehabilitation referral

Vocational rehabilitation referrals would be those individuals who have physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973, or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification would be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(5) Qualified summer youth employee

Qualified summer youth employees would be individuals: (1) who perform services during any 90-day period between May 1 and September 15; (2) who are certified by the designated local agency as being 16 or 17 years of age on the hiring date; (3) who have not been an employee of

that employer before; and (4) who are certified by the designated local agency as having a principal place of abode within an empowerment zone or enterprise community. As with high-risk youths, no credit would be available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone or enterprise community (as defined under Subchapter U of the Internal Revenue Code). If, after the end of the 90-day period, the employer continued to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages would take into account wages paid to the youth while a qualified summer youth employee.

Definition of wages and other rules

In general, wages eligible for the credit would be defined by reference to the definition of wages under the Federal Unemployment Tax Act ("FUTA") in section 3306(b) of the Code, except that the dollar limits would not apply.

Wages would be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee would be for services in the employer's trade or business. The test as to whether more than one-half of an employee's wages would be for services in a trade or business would be applied to each separate employer without treating related employers as a single employer.

In order to prevent taxpayers from eliminating all tax liability by reason of the credit, the amount of the credit would not exceed 90 percent of the taxpayer's income tax liability. Furthermore, the credit would be allowed only after certain other nonrefundable credits had been taken. If, after applying these other credits, 90 percent of an employer's remaining tax liability for the year was less than the targeted jobs tax credit, the excess credit could be carried back three years and carried forward 15 years.

All employees of all corporations that are members of a controlled group of corporations would be treated as if they were employees of the same corporation for purposes of determining the years of employment of any employee and wages for any employee up to $6,000. Generally, under the controlled group rules, the credit allowed the group is the same as if the group were a single company. A comparable rule would be provided in the case of partnerships, sole proprietorships, and other trades or businesses (whether or not incorporated) that are under common control, so that all employees of such organizations generally would be treated as if they was employed by a single person. The amount of the credit allowable to each member of the controlled group would be its proportionate share of the wages giving rise to the credit.

No credit would be available for the hiring of certain related individuals (primarily dependents or owners of the taxpayer). The credit would also not be available for wages paid to an individual who is employed by the employer at any time during which the individual is not a certified member of a targeted group.

Minimum employment period

No credit would be allowed for wages paid unless the eligible individual is employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 500 hours (120 hours in the case of a qualified summer youth employee).

Business awareness program

The Secretary of Labor would establish a program to encourage small businesses to work with the designated local agencies to identify eligible individuals for inclusion in the credit program. The Secretary and heads of other Federal agencies also would be directed to simplify credit procedures to encourage participation.

Effective Date

The credit would be effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 1996, and before January 1, 1998.

Legislative Background

The targeted jobs tax credit was enacted in the Revenue Act of 1978 as a substitute for the new jobs credit.[2] The targeted jobs tax credit, as initially enacted, provided a credit to employers of seven targeted groups. These groups were: (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 to 25; (3) economically disadvantaged Vietnam-era veterans under the age of 35; (4) SSI recipients (individuals receiving Supplemental Security Income under Title XVI of the Social Security Act, including certain State supplements); (5) general assistance recipients; (6) economically disadvantaged former convicts hired within five years of the later of release from prison or date of conviction; and (7) cooperative education students aged 16 to 19 who had not graduated from high school or vocational school. The maximum credit equaled 50 percent of the first $6,000 of qualified first-year wages and 25 percent of the first $6,000 qualified second-year wages paid to a targeted group individual. The employer's deduction for wages was reduced by the amount of the credit. The credit was effective for wages paid or incurred before January 1, 1982.

The Economic Recovery Tax Act of 1981 ("ERTA") extended the credit to individuals who began work for the employer before January 1, 1983. Because of the two-year nature of the credit, it applied to wages paid in 1983 and 1984. ERTA also added new categories of individuals whose employment qualified for the credit: (1) involuntarily terminated Comprehensive Employment and Training Act ("CETA") workers; (2) WIN registrants; and (3) AFDC recipients. Other major changes made in ERTA were limiting the credit to economically disadvantaged cooperative education students rather than all such students meeting the age requirements and the

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[2] The new jobs credit was available in 1977 and 1978.

repeal of the age limit for Vietnam-era veterans.

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") extended the credit to individuals who began work for the employer before January 1, 1985, and applied to wages paid through 1986. TEFRA also deleted CETA workers as a targeted group and added a new targeted group of economically disadvantaged summer youths aged 16 or 17. Employers of economically disadvantaged summer youths were eligible for a maximum credit of 85 percent of the first $3,000 of qualified wages. The Deficit Reduction Act of 1984 ("DEFRA") extended the credit to individuals who began work for the employer before January 1, 1986.

The Tax Reform Act of 1986 ("1986 Act") extended the credit to wages paid to targeted group individuals who began work for an employer after December 31, 1985 and before January 1, 1989. Major changes enacted in the 1986 Act included the elimination of the credit for second-year wages and a reduction in the first-year credit to 40 percent of the first $6,000 of qualified wages.

The Technical and Miscellaneous Revenue Act of 1988 ("1988 Act") extended the credit to eligible individuals who began work for an employer between January 1, 1989, and December 31, 1989. Major changes enacted in the 1988 Act were: (1) a reduction in the age limit for economically disadvantaged youth to ages 18-22 rather than 18-25; and (2) a reduction in the maximum amount of the credit for economically disadvantaged summer youth from 85 percent to 40 percent of the first $3,000 of qualified wages.

The Omnibus Budget Reconciliation Act of 1989, the Omnibus Budget Reconciliation Act of 1990, and the Tax Extension Act of 1991 extended the credit to eligible individuals who began work for the employer before October 1, 1990, January 1, 1992 and June 30, 1992, respectively. Most recently, the Omnibus Budget Reconciliation Act of 1993 extended the credit to eligible individuals who began work for the employer before January 1, 1995.

B. Employer-Provided Educational Assistance

Present and Prior Law

Under present law, an employee must include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to an employee, unless the cost of such assistance qualifies as a deductible job-related expense of the employee. Amounts expended for education qualify as deductible job-related expenses if the education (1) maintains or improves skills required for the employee's current job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continued employment in the employee's current job (Treas. Reg. sec. 1.162-5(a)). Such expenses (if not reimbursed by the employer) are deductible only to the extent that, when aggregated with other miscellaneous itemized deductions, they exceed 2 percent of the taxpayer's adjusted gross income. No deduction (or exclusion) is allowed for expenses incurred to qualify for a new trade or business.

Under prior law (sec. 127), an employee's gross income and wages did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements. This exclusion, which expired for taxable years beginning after December 31, 1994, was limited to $5,250 of educational assistance with respect to an individual during a calendar year.

Description of Proposal

The proposal would extend the exclusion for educational assistance for taxable years beginning after December 31, 1994, and before January 1, 1998. In years beginning after December 31, 1995, the exclusion would not apply with respect to graduate-level courses.

Effective Date

The proposal would be effective with respect to taxable years beginning after December 31, 1994, and the restriction of the exclusion to undergraduate education would be effective for taxable years beginning after December 31, 1995.

Legislative Background

The section 127 exclusion for employer-provided educational assistance was first established on a temporary basis by the Revenue Act of 1978 (through 1983). It subsequently was extended, again on a temporary basis, by Public Law 98-611 (through 1985), by the Tax Reform Act of 1986 (through 1987), by the Technical and Miscellaneous Revenue Act of 1988 (through 1988), by the Omnibus Budget Reconciliation Act of 1989 (through September 30, 1990), by the Omnibus Budget Reconciliation Act of 1990 (through 1991), by the Tax Extension

Act of 1991 (through June 30, 1992), and by the Omnibus Budget Reconciliation Act of 1993 (through December 31, 1994). Public Law 98-611 adopted a $5,000 annual limit on the exclusion; this limit was subsequently raised to $5,250 in the Tax Reform Act of 1986. The Technical and Miscellaneous Revenue Act of 1988 made the exclusion inapplicable to graduate-level courses. The restriction on graduate-level courses was repealed by the Omnibus Budget Reconciliation Act of 1990, effective for taxable years beginning after December 31, 1990.

C. Research and Development Tax Credit

Prior Law

General rule

Prior to July 1, 1995, section 41 of the Internal Revenue Code provided for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceed its base amount for that year. The research tax credit expired and does not apply to amounts paid or incurred after June 30, 1995.

A 20-percent research tax credit also applied to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over
(2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the "university basic research credit" (see sec. 41(e)).

Computation of allowable credit

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of .03.[3]

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[3] The Omnibus Budget Reconciliation Act of 1993 included a special rule designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm (i.e., any taxpayer that did not have gross receipts in at least three years during the 1984-1988 period) will be assigned a fixed base percentage of .03 for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. In the event that the research credit is extended beyond the scheduled June 30, 1995 expiration date, a start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenditures will be a phased-in ratio based on its actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage will be its actual ratio of qualified research expenditures to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993 (sec.

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

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, research expenditures and gross receipts of the taxpayer are aggregated with research expenditures and gross receipts of certain related persons for purposes of computing any allowable credit (sec. 41(f)(1)). Special rules apply for computing the credit when a major portion of a business changes hands, under which qualified research expenditures and gross receipts for periods prior to the change or ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage (sec. 41(f)(3)).

Eligible expenditures

Qualified research expenditures eligible for the research tax credit consist of: (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses").

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must pertain to functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors (sec. 41(d)(3)). In addition, research does not qualify for the credit if conducted after the beginning of commercial production of the business component, if related to the adaptation of an existing business component to a particular customer's requirements, if related to the duplication of an existing business component from a physical examination of the component itself or certain other information, or if related to certain efficiency surveys, market research or development, or routine quality control (sec. 41(d)(4)).

Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

41(c)(3)(B)).

Relation to deduction

Deductions for expenditures allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year. Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

Description of Proposal

The research tax credit (including the university basic research credit) would be extended for the period July 1, 1995, through December 31, 1997.

The proposal also would expand the definition of "start-up firms" under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983.

In addition, the proposal provides that taxpayers would be allowed to irrevocably elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer would be assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise would be reduced. A credit rate of 1.65 percent would apply to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1 percent (i.e., the base amount would equal 1 percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 2.2 percent would apply to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of 2 percent. A credit rate of 2.75 percent would apply to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 2 percent. Under the proposal, an election to be subject to this alternative incremental credit regime may be made only for a taxpayer's first taxable year beginning after June 30, 1995, and such an election would apply to that taxable year and all subsequent years unless revoked with the consent of the Secretary of the Treasury.

The proposal also provides for a special rule for payments made to a qualified research consortium. Under this special rule, 75 percent of amounts paid to a qualified research consortium for qualified research would be treated as qualified research expenses eligible for the research credit (rather than 65 percent under the present-law section 41(b)(3) rule governing contract research expenses). For this purpose, a qualified research consortium would be defined as a nonprofit scientific research organization that is described in section 501(c)(3) (but not a college or university) if (1) at least 15 unrelated persons paid amounts to the organization for qualified research during the calendar year in which the taxable year of the taxpayer begins, (2) no

three persons paid more than 50 percent of such amounts, and (3) no one person paid more than 20 percent of such amounts.

Effective Date

The proposal would be effective for expenditures paid or incurred during the period July 1, 1995, through December 31, 1997. Taxpayers could elect the alternative research credit regime (with lower fixed-base percentages and lower credit rates) for taxable years beginning after June 30, 1995. The special rule for payments made to a qualified research consortium would be effective for taxable years beginning after June 30, 1995.

Legislative Background

The research tax credit initially was enacted in the Economic Recovery Tax Act of 1981 as a credit equal to 25 percent of the excess of qualified research expenses incurred in the current taxable year over the average of qualified research expenses incurred in the prior three taxable years. The research tax credit was modified in the Tax Reform Act of 1986, which (1) extended the credit through December 31, 1988, (2) reduced the credit rate to 20 percent, (3) tightened the definition of qualified research expenses eligible for the credit, and (4) enacted the separate, university basic research credit.

The Technical and Miscellaneous Revenue Act of 1988 ("1988 Act") extended the research tax credit for one additional year, through December 31, 1989. The 1988 Act also reduced the deduction allowed under section 174 (or any other section) for qualified research expenses by an amount equal to 50 percent of the research tax credit determined for the year.

The Omnibus Budget Reconciliation Act of 1989 ("1989 Act") effectively extended the research credit for nine months (by prorating qualified expenses incurred before January 1, 1991). The 1989 Act also modified the method for calculating a taxpayer's base amount (i.e., by substituting the present-law method which uses a fixed-base percentage for the prior-law moving base which was calculated by reference to the taxpayer's average research expenses incurred in the preceding three taxable years). The 1989 Act further reduced the deduction allowed under section 174 (or any other section) for qualified research expenses by an amount equal to 100 percent of the research tax credit determined for the year.

The Omnibus Budget Reconciliation Act of 1990 extended the research tax credit through December 31, 1991 (and repealed the special rule to prorate qualified expenses incurred before January 1, 1991).

The Tax Extension Act of 1991 extended the research tax credit for six months (i.e., for qualified expenses incurred through June 30, 1992).

The Omnibus Budget Reconciliation Act of 1993 ("1993 Act") extended the research tax

credit for three years -- i.e., retroactively from July 1, 1992 through June 30, 1995. The 1993 Act also provided a special rule for start-up firms, so that the fixed-base ratio of such firms eventually will be computed by reference to their actual research experience.

D. Contributions of Appreciated Stock to Private Foundations

Present and Prior Law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization.[4] However, in the case of a charitable contribution of short-term gain, inventory, or other ordinary income property, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, a taxpayer's deduction is limited to the adjusted basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose (sec. 170(e)(1)(B)(i)).[5]

In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to taxpayer's basis in the property (sec. 170(e)(1)(B)(ii)). However, under a special rule contained in section 170(e)(5), taxpayers were allowed a deduction equal to the fair market value of "qualified appreciated stock" contributed to a private foundation prior to January 1, 1995. Qualified appreciated stock was defined as any stock of a corporation for which (as of the date of contribution) market quotations are readily available on an established securities market and which is capital gain property. The fair-market-value deduction for qualified appreciated stock donated to a private foundation applied only to the extent that the cumulative aggregate amount of donations made by the donor to one or more private foundations of stock in a particular corporation did not exceed 10 percent in value of the outstanding stock of that corporation. For this purpose, an individual was treated as making all contributions that were made by any member of the individual's family (as defined in sec. 267(c)(4)).

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[4] The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)).

[5] As part of the Omnibus Budget Reconciliation Act of 1993, Congress eliminated the treatment of contributions of appreciated property (real, personal, and intangible) as a tax preference for alternative minimum tax (AMT) purposes. Thus, if a taxpayer makes a gift to charity of property (other than short-term gain, inventory, or other ordinary income property, or gifts to private foundations) that is real property, intangible property or tangible personal property the use of which is related to the donee's tax-exempt purpose, the taxpayer is allowed to claim the same fair-market-value deduction for both regular tax and AMT purposes (subject to present-law percentage limitations).

Description of Proposal

The proposal would extend the special rule contained in section 170(e)(5) for contributions of qualified appreciated stock made to private foundations during the period January 1, 1995, through December 31, 1997.

Effective Date

The proposal would be effective for contributions of qualified appreciated stock to private foundations made during the period January 1, 1995, through December 31, 1997.

Legislative Background

The special rule for gifts of publicly traded stock to private foundation (i.e., sec. 170(e)(5)) was enacted as part of the Deficit Reduction Act of 1984, effective for donations made after July 18, 1984, and prior to January 1, 1995.

E. Orphan Drug Tax Credit

Prior Law

Prior to January 1, 1995, a 50-percent nonrefundable tax credit was allowed under section 28 for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA. A rare disease or condition is defined as one that (1) affects less than 200,000 persons in the United States or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for it from U.S. sales of the drug. These rare diseases and conditions include Huntington's disease, myoclonus, ALS (Lou Gehrig's disease), Tourette's syndrome, and Duchenne's dystrophy (a form of muscular dystrophy).

The orphan drug tax credit expired on December 31, 1994.

Description of Proposal

The orphan drug tax credit would be extended for the period January 1, 1995, through December 31, 1997.

Effective Date

The proposal would be effective for qualified clinical testing expenses paid or incurred during the period January 1, 1995, through December 31, 1997.

Legislative Background

The orphan drug tax credit originally was enacted in the Orphan Drug Act of 1983, and was scheduled to expire after 1987. The Tax Reform Act of 1986 extended the credit for three years, through December 31, 1990. The Omnibus Budget Reconciliation Act of 1990 further extended the orphan drug tax credit for one year, through December 31, 1991.

The Tax Extension Act of 1991 extended the orphan drug tax credit for six months, through June 30, 1992. The Omnibus Budget Reconciliation Act of 1993 extended the orphan drug tax credit for 30 months (i.e., for qualified clinical testing expenses incurred through December 31, 1994).

II. PERMANENT EXTENSION OF FUTA EXEMPTION FOR ALIEN AGRICULTURAL WORKERS

Prior Law

Generally, Federal Unemployment Tax ("FUTA") is imposed on farm operators who (1) employ 10 or more agricultural workers for some portion of each of 20 different days, each day being in a different calendar week or (2) have a quarterly payroll for agricultural services of at least $20,000. An exclusion from FUTA was provided, however, for labor performed by an alien admitted to the United States to perform agricultural labor under sections 214(c) and 101(a)(15)(H) of the Immigration and Nationality Act. This exclusion was effective for labor performed before January 1, 1995. For these purposes, the term agricultural labor generally has the same meaning (except for certain cooperative organizations) as used for FICA tax purposes.

Description of Proposal

The proposal would permanently extend the exemption.

Effective Date

The proposal would be effective for labor performed on or after January 1, 1995.

Legislative Background

The Unemployment Compensation Amendments of 1976 provided the exclusion for certain agricultural labor performed before January 1, 1980. The Unemployment Compensation Amendments of 1978 extended the exclusion to labor performed before January 1, 1982. The Tax Equity and Fiscal Responsibility Act of 1982 extended the exclusion to labor performed before January 1, 1984. The Federal Supplemental Compensation Amendments of 1983 extended the exclusion to labor performed before January 1, 1986. The Omnibus Budget Reconciliation Act of 1985 extended the exclusion to labor performed before January 1, 1988. The Alien Farmworkers Tax Exclusion Act of 1986 extended the exclusion to labor performed before January 1, 1993. Most recently, the Unemployment Compensation Amendments of 1992 extended the exclusion to labor performed before January 1, 1995.

III. TRANSPORTATION FUELS TAX EXEMPTION FOR FUELS USED IN COMMERCIAL AVIATION

Present Law

A 4.3-cents-per-gallon deficit reduction excise tax is imposed on fuel used in most transportation modes. Fuels subject to the tax include gasoline (including gasoline blended with alcohol, "gasohol"), diesel fuel, special motor fuels, propane, compressed natural gas, aviation fuels (jet fuel and gasoline), and any other motor fuel used in shipping in the inland waterway system. The transportation modes subject to tax include highway, rail, air, inland waterway, and motorboats and other recreational boats. Fuel consumed before October 1, 1995, in commercial aviation, defined as the air transportation of persons or property for hire, is exempt from this tax.

Revenues from this transportation fuels tax are deposited in the General Fund of the Treasury. This tax is separate from, and in addition to, any user-based excise taxes imposed on the same fuels to fund the Highway Trust Fund, the Airport and Airway Trust Fund, the Leaking Underground Storage Tank Trust Fund, the Inland Waterways Trust Fund, or the Aquatic Resources Trust Fund.

Description of Proposal

Extend exemption

The present exemption for commercial aviation fuels would be extended for two years, through September 30, 1997. Thereafter, the full 4.3-cents-per-gallon tax would be imposed.

Treasury Department study

Several questions have arisen regarding the relative excise tax burdens of different transportation modes and Federal benefits financed with excise taxes on those transportation modes. The proposal would direct the Treasury Department, in consultation with the Transportation Department, to study the relative excise tax burdens of various modes of transportation and the Federal benefits derived from those taxes by each such mode. The results of this study would be required to be submitted to the Congressional tax-writing committees no later than June 30, 1996.

Effective Date

The proposal would be effective after September 30, 1995.

Under present law, this excise tax will be imposed beginning on October 1, 1995, and the floor stocks tax imposed by the Omnibus Budget Reconciliation Act of 1993 will be imposed on October 1, 1995. While the proposal would defer this imposition for two years, retroactive to

October 1, 1995, it is unlikely that the proposal will be enacted before these taxes take effect. Therefore, the proposal would provide refunds to commercial aviation users for any such taxes paid during the period before enactment upon adequate documentation that tax-paid fuel was purchased. Further, the proposal would anticipate that, if the tax is repealed retroactive to October 1, 1995, the Internal Revenue Service would not impose any penalties and interest on taxpayers who fail to pay the tax during the period prior to enactment.

Appropriate floor stocks taxes would be imposed on October 1, 1997.

IV. EXTENSION OF AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES

Present Law

Five separate excise taxes are imposed under present law to fund the Federal Airport and Airway Trust Fund program. In general, these taxes are scheduled to expire after December 31, 1995. Current trust fund authorizations extend through September 30, 1996. The aviation excise taxes are:

(1) a 10-percent tax on domestic passenger tickets;

(2) a 6.25-percent tax on domestic freight waybills;

(3) a $6-per-person tax on international departures;

(4) a 17.5-cents-per-gallon tax on jet fuel used in noncommercial aviation; and

(5) a 15-cents-per-gallon tax on gasoline used in noncommercial aviation.

Description of Proposal

The current Airport and Airway Trust Fund excise taxes, and transfer of these revenues to the Trust Fund, would be extended for nine months, through September 30, 1996.

Effective Date

The proposal would be effective on the date of enactment.