[JOINT COMMITTEE PRINT]

GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 112TH CONGRESS

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

FEBRUARY 2013

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation in consultation with the staffs of the House Committee on Ways and Means and the Senate Committee on Finance, provides an explanation of tax legislation enacted in the 112th Congress. The explanation follows the chronological order of the tax legislation as signed into law.

For each provision, the document includes a description of present law, explanation of the provision, and effective date. Present law describes the law in effect immediately prior to enactment. It does not reflect changes to the law made by the provision or subsequent to the enactment of the provision. For many provisions, the reasons for change are also included. In some instances, provisions included in legislation enacted in the 112th Congress were not reported out of committee before enactment. For example, in some cases, the provisions enacted were included in bills that went directly to the House and Senate floors. As a result, the legislative history of such provisions does not include the reasons for change normally included in a committee report. In the case of such provisions, no reasons for change are included with the explanation of the provision in this document.

In some cases, there is no legislative history for enacted provisions. For such provisions, this document includes a description of present law, explanation of the provision, and effective date, as prepared by the staff of the Joint Committee on Taxation. In some cases, technical explanations of certain bills were prepared and published by the staff of the Joint Committee. In those cases, this document follows the technical explanations. Section references are to the Internal Revenue Code of 1986, as amended, (the "Code") unless otherwise indicated.

Part One is an explanation of the provisions relating to the extension of the Highway Trust Fund expenditure authority and restoration of the fund (Pub. L. Nos. 112–5, 112–30, 112–102, 112–140, and 112–141).

Part Two is an explanation of the provisions relating to the extension of the Airport and Airway Trust Fund excise taxes and expenditure authority (Pub. L. Nos. 112–7, 112–16, 112–21, 112–27, 112–30, and 112–91).

Part Three is an explanation of the provisions of the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011 (Pub. L. No. 112–9).

Part Four is an explanation of the provision repealing free-choice vouchers in the Department of Defense and Full-Year Continuing Appropriations Act of 2011 (Pub. L. 112–10).

[1] This document may be cited as follows: Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 112th Congress (JCS–2–13), February 2013.

Part Five is an explanation of the provision relating to the extension of health coverage tax credit improvements in the Trade Adjustment Assistance Extension Act of 2011 (Pub. L. No. 112–40).

Part Six is an explanation of the revenue provisions of the United States-Korea Free Trade Agreement Implementation Act relating to an increase in the penalty for paid preparers who fail to comply with earned income tax credit due diligence requirements, the requirement for certain prisons to provide information for tax administration, certain fees and the timing of corporate estimated taxes (Pub. L. No. 112–41).

Part Seven is an explanation of the provisions relating to the repeal of three-percent withholding on certain payments made to vendors, extending the work opportunity tax credit to employers of certain veterans, allowing Treasury to levy up to 100 percent of a payment to a Medicare provider to collect unpaid taxes, a Treasury study on reducing the amount of the tax gap owed by federal contractors and a modification of the calculation of modified adjusted gross income for determining eligibility for certain healthcare-related programs (Pub. L. No. 112–56).

Part Eight is an explanation of the provisions relating to a temporary payroll tax cut (Pub. L. No. 112–78).

Part Nine is an explanation of the provisions relating to certain airport and airway provisions, and other revenue provisions in the FAA Modernization and Reform Act of 2012 (Pub. L. No. 112–95).

Part Ten is an explanation of the revenue provisions in the Middle Class Tax Relief and Job Creation Act of 2012 (Pub. L. No. 112–96).

Part Eleven is an explanation of the revenue provision of the National Defense Authorization Act for Fiscal Year 2013 relating to a modification of the definition of public safety officers.

Part Twelve is an explanation of the revenue provisions of the American Taxpayer Relief Act of 2012 (Pub. L. No. 112–240) relating to permanent extension of certain individual income tax and estate and gift provisions, other temporary individual tax relief provisions and temporary extension of certain other expiring provisions.

Part Thirteen is an explanation of the provisions relating to the extension of custom user fees and the modification of corporate estimated tax payments. (Pub. L. Nos. 112–42; 112–43, 112–96, and 112–163).

The Appendix provides the estimated budget effects of tax legislation enacted in the 112th Congress.

The first footnote in each Part gives the legislative history of each of the Acts of the 112th Congress discussed in that Part.

PART ONE: HIGHWAY TRUST FUND RELATED LEGISLATION (PUBLIC LAWS 112–5,[2] 112–30,[3] 112–102,[4] 112–140,[5] AND 112–141 [6])

A. Short-Term Extensions of Highway Trust Fund Expenditure and Tax Authority (Public Laws 112–5, 112–30, 112–102, 112–140 and 112–141)

Present Law

Under present law, the Internal Revenue Code (sec. 9503) authorizes expenditures (subject to appropriations) to be made from the Highway Trust Fund (and Sport Fish Restoration and Boating Trust Fund) through March 4, 2011, for purposes provided in specified authorizing legislation as in effect on the date of enactment. The taxes dedicated to the Highway Trust Fund and Leaking Underground Storage Tank Trust Fund are authorized through September 30, 2011.

Explanation of Provisions

Pub. L. No. 112–5 (the "Surface Transportation Extension Act of 2011")

This provision extends the authority to make expenditures (subject to appropriations) from the Highway Trust Fund through September 30, 2011. The Act also updates the cross-references to authorizing legislation to include expenditure purposes in this Act as in effect on the date of enactment. It also extends the expenditure authority for the Sport Fish Restoration and Boating Trust Fund through September 30, 2011.

Effective Date

The provision is effective March 4, 2011.

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[2] H.R. 662. The House passed H.R. 662 on March 2, 2011. The bill passed the Senate without amendment on March 3, 2011. The President signed the bill on March 4, 2011.

[3] H.R. 2887. The House passed H.R. 2887 on September 13, 2011. The bill passed the Senate without amendment on September 15, 2011. The President signed the bill on September 16, 2011.

[4] H.R. 4281. The House passed H.R. 4281 on March 29, 2012. The bill passed the Senate without amendment on March 29, 2012. The President signed the bill on March 30, 2012.

[5] H.R. 6064. The House passed H.R. 6064 on June 29, 2012. The bill passed the Senate without amendment on June 29, 2012. The President signed the bill on June 29, 2012.

[6] H.R. 4348. The House passed H.R. 4348 on April 18, 2012. The Senate Committee on Finance reported S. 2132 on February 27, 2012, with a report (S. Rep. No. 112–152). The Senate passed H.R. 4348 with an amendment incorporating the text of S. 1813 on April 24, 2012. The conference report was filed on June 28, 2012 (H.R. Rep. No. 112–557) and was passed by the House on June 29, 2012, and the Senate on June 29, 2012. The President signed the bill on July 6, 2012.

Pub. L. No. 112–30 (the "Surface and Air Transportation Programs Extension Act of 2011")

This provision extends the authority to make expenditures (subject to appropriations) from the Highway Trust Fund through March 31, 2012. The Act also updates the cross-references to authorizing legislation to include expenditure purposes in this Act as in effect on the date of enactment. It also extends the expenditure authority for the Sport Fish Restoration and Boating Trust Fund through March 31, 2012. The highway-related taxes are also extended through March 31, 2012.

Effective Date

The provision is effective October 1, 2011.

Pub. L. No. 112–102 (the "Surface Transportation Extension Act of 2012")

This provision extends the authority to make expenditures (subject to appropriations) from the Highway Trust Fund through June 30, 2012. The Act also updates the cross-references to authorizing legislation to include expenditure purposes in this Act as in effect on the date of enactment. It also extends the expenditure authority for the Sport Fish Restoration and Boating Trust Fund through June 30, 2012. Generally, the highway-related taxes are also extended through June 30, 2012. The heavy vehicle use tax is extended through September 30, 2013.

Effective Date

The provision is effective April 1, 2012.

Pub. L. No. 112–140 (the "Temporary Surface Transportation Extension Act of 2012")

This provision extends the authority to make expenditures (subject to appropriations) from the Highway Trust Fund through July 6, 2012. The Act also updates the cross-references to authorizing legislation to include expenditure purposes in this Act as in effect on the date of enactment. It also extends the expenditure authority for the Sport Fish Restoration and Boating Trust Fund through July 6, 2012. Generally, the highway-related taxes are also extended through July 6, 2012. The Act makes a technical correction to the heavy vehicle use tax to provide that the taxable period means any year beginning before July 1, 2013, and ends at the close of September 30, 2013.

Effective Date

In general, the provision is effective on June 29, 2012. The technical correction to the heavy vehicle use tax takes effect as if included in section 402 of the Surface Transportation Extension Act of 2012.

B. Short-Term Extensions of the Leaking Underground Storage Tank Trust Fund Financing Rate (Public Laws 112–30, 112–102, and 112–140)

Present Law

Leaking Underground Storage Tank Trust Fund financing rate

Fuels of a type subject to other trust fund excise taxes generally are subject to an add-on excise tax of 0.1-cent-per-gallon to fund the Leaking Underground Storage Tank ("LUST") Trust Fund.[7] For example, the LUST excise tax applies to gasoline, diesel fuel, kerosene, and most alternative fuels subject to highway and aviation fuels excise taxes, and to fuels subject to the inland waterways fuel excise tax. This excise tax is imposed on both uses and parties subject to the other taxes, and to situations (other than export) in which the fuel otherwise is tax-exempt. For example, off-highway business use of gasoline and off-highway use of diesel fuel and kerosene generally are exempt from highway motor fuels excise tax. Similarly, States and local governments and certain other parties are exempt from such tax. Nonetheless, all such uses and parties are subject to the 0.1-cent-per-gallon LUST excise tax.

Liquefied natural gas, compressed natural gas, and liquefied petroleum gas are exempt from the LUST tax. Additionally, methanol and ethanol fuels produced from coal (including peat) are taxed at a reduced rate of 0.05 cents per gallon.

The LUST tax is scheduled to expire after October 1, 2011.[8]

Explanation of Provision

Pub. L. No. 112–30 (the "Surface and Air Transportation Programs Extension Act of 2011")

This provision extends the LUST Trust Fund financing rate through March 31, 2012.

Effective Date

The provision is effective October 1, 2011.

Pub. L. No. 112–102 (the "Surface Transportation Extension Act of 2012")

This provision extends the LUST Trust Fund financing rate through June 30, 2012.

Effective Date

The provision is effective April 1, 2012.

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[7] Secs. 4041, 4042, and 4081.

[8] For Federal budget scorekeeping purposes, the LUST Trust Fund tax, like other excise taxes dedicated to trust funds, is assumed to be permanent.

Pub. L. No. 112–140 (the "Temporary Surface Transportation Extension Act of 2012")

This provision extends the LUST Trust Fund financing rate through July 6, 2012.[9]

Effective Date

The provision is effective on June 29, 2012.

C. Revenue Provisions in the Moving Ahead for Progress in the 21st Century Act or the "MAP–21" (Public Law 112–141)

1. Extension of trust fund expenditure authority and extension of highway-related taxes (sec. 40101 and 40102 of the Act, and secs. 4041, 4051, 4071, 4081, 4221, 4481, 4483, 6412, 9503, 9504, and 9508 of the Code)

Present Law Highway Trust Fund Taxes

In general

Six separate excise taxes are imposed to finance the Federal Highway Trust Fund program. Three of these taxes are imposed on highway motor fuels. The remaining three are a retail sales tax on heavy highway vehicles, a manufacturers' excise tax on heavy vehicle tires, and an annual use tax on heavy vehicles. A substantial majority of the revenues produced by the Highway Trust Fund excise taxes are derived from the taxes on motor fuels. The annual use tax on heavy vehicles expires October 1, 2013. Except for 4.3 cents per gallon of the Highway Trust Fund fuels tax rates, the remaining taxes are scheduled to expire after June 30, 2012. The 4.3-cents-per-gallon portion of the fuels tax rates is permanent.[10] The six taxes are summarized below.

Highway motor fuels taxes

The Highway Trust Fund motor fuels tax rates are as follows: [11]

Gasoline	18.3 cents per gallon
Diesel fuel and kerosene	24.3 cents per gallon
Alternative fuels	18.3 or 24.3 cents per gallon generally [12]

Non-fuel Highway Trust Fund excise taxes

In addition to the highway motor fuels excise tax revenues, the Highway Trust Fund receives revenues produced by three excise taxes imposed exclusively on heavy highway vehicles or tires. These taxes are:

[9] The LUST Trust Fund financing rate was further extended through September 30, 2016 by Pub. L. No. 112–141 (Moving Ahead for Progress in the 21st Century Act" or the "MAP–21"), discussed infra.

[10] This portion of the tax rates was enacted as a deficit reduction measure in 1993. Receipts from it were retained in the General Fund until 1997 legislation provided for their transfer to the Highway Trust Fund.

[11] Secs. 4081(a)(2)(A)(i), 4081(a)(2)(A)(iii), 4041(a)(2), 4041(a)(3), and 4041(m). Some of these fuels also are subject to an additional 0.1-cent-per-gallon excise tax to fund the LUST Trust Fund (secs. 4041(d) and 4081(a)(2)(B)).

[12] See secs. 4041(a)(2), 4041(a)(3), and 4041(m).

1. A 12-percent excise tax imposed on the first retail sale of heavy highway vehicles, tractors, and trailers (generally, trucks having a gross vehicle weight in excess of 33,000 pounds and trailers having such a weight in excess of 26,000 pounds);[13]

2. An excise tax imposed on highway tires with a rated load capacity exceeding 3,500 pounds, generally at a rate of 0.945 cents per 10 pounds of excess;[14] and

3. An annual use tax imposed on highway vehicles having a taxable gross weight of 55,000 pounds or more.[15] (The maximum rate for this tax is $550 per year, imposed on vehicles having a taxable gross weight over 75,000 pounds.)

The taxable year for the annual use tax is from July 1st through June 30th of the following year. For the period July 1, 2013, through September 30, 2013, the amount of the annual use tax is reduced by 75 percent.[16]

Present Law Highway Trust Fund Expenditure Provisions

In general

Under present law, revenues from the highway excise taxes, as imposed through June 30, 2012, generally are dedicated to the Highway Trust Fund. Dedication of excise tax revenues to the Highway Trust Fund and expenditures from the Highway Trust Fund are governed by the Code.[17] The Code authorizes expenditures (subject to appropriations) from the Highway Trust Fund through June 30, 2012, for the purposes provided in authorizing legislation, as such legislation was in effect on the date of enactment of the Surface Transportation Extension Act of 2012.

Highway Trust Fund expenditure purposes

The Highway Trust Fund has a separate account for mass transit, the Mass Transit Account.[18] The Highway Trust Fund and the Mass Transit Account are funding sources for specific programs.

Highway Trust Fund expenditure purposes have been revised with each authorization Act enacted since establishment of the Highway Trust Fund in 1956. In general, expenditures authorized under those Acts (as the Acts were in effect on the date of enactment of the most recent such authorizing Act) are specified by the Code as Highway Trust Fund expenditure purposes.[19] The Code

[13] Sec. 4051.
[14] Sec. 4071.
[15] Sec. 4481.
[16] Sec. 4482(c)(4) and (d).
[17] Sec. 9503. The Highway Trust Fund statutory provisions were placed in the Internal Revenue Code in 1982.
[18] Sec. 9503(e)(1).
[19] The authorizing Acts that currently are referenced in the Highway Trust Fund provisions of the Code are: the Highway Revenue Act of 1956; Titles I and II of the Surface Transportation Assistance Act of 1982; the Surface Transportation and Uniform Relocation Act of 1987; the Intermodal Surface Transportation Efficiency Act of 1991; the Transportation Equity Act for the 21st Century, the Surface Transportation Extension Act of 2003, the Surface Transportation Extension Act of 2004; the Surface Transportation Extension Act of 2004, Part II; the Surface Transportation Extension Act of 2004, Part III; the Surface Transportation Extension Act of 2004, Part IV; the Surface Transportation Extension Act of 2004, Part V; the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users; the SAFETEA–LU Technical

Continued

provides that the authority to make expenditures from the Highway Trust Fund expires after June 30, 2012. Thus, no Highway Trust Fund expenditures may occur after June 30, 2012, without an amendment to the Code.

As noted above, section 9503 appropriates to the Highway Trust Fund amounts equivalent to the taxes received from the following: the taxes on diesel, gasoline, kerosene and special motor fuel, the tax on tires, the annual heavy vehicle use tax, and the tax on the retail sale of heavy trucks and trailers.[20] Section 9601 provides that amounts appropriated to a trust fund pursuant to sections 9501 through 9511, are to be transferred at least monthly from the General Fund of the Treasury to such trust fund on the basis of estimates made by the Secretary of the Treasury of the amounts referred to in the Code section appropriating the amounts to such trust fund. The Code requires that proper adjustments be made in amounts subsequently transferred to the extent prior estimates were in excess of, or less than, the amounts required to be transferred.

Reasons for Change[21]

Communities and businesses depend on effective transportation to help them grow. The projects funded by the Highway Trust Fund ensure safety and mobility, sustain and create jobs, reduce traffic congestion, improve air quality and fund infrastructure projects of regional and national significance across the country. Therefore, Congress believes it is appropriate to reauthorize Highway Trust Fund expenditures through September 30, 2014, and to extend current Federal taxes payable to the Highway Trust Fund.

Explanation of Provision

The Act provides for expenditure authority through September 30, 2014. The Code provisions governing the purposes for which monies in the Highway Trust Fund may be spent are updated to include the reauthorization bill, MAP–21. Cross-references to the reauthorization bill in the Code provisions governing the Sport Fish Restoration and Boating Trust Fund are also updated to include the conference agreement bill. In general, the provision extends the taxes dedicated to the Highway Trust Fund at their present law rates through September 30, 2016, and for the heavy vehicle use tax, through September 30, 2017.[22]

Effective Date

The provision is effective July 1, 2012.

Corrections Act of 2008; the Surface Transportation Extension Act of 2010; the Surface Transportation Extension Act of 2010, Part II; the Surface Transportation Extension Act of 2011; the Surface Transportation Extension Act of 2011, Part II, and the Surface Transportation Extension Act of 2012.

[20] Sec. 9503(b)(1).

[21] See S. Rep. 112–152 (February 27, 2012) at 5 (the Committee report accompanying S. 2132, the "Highway Investment, Job Creation, and Economic Growth Act of 2012" as reported by the Senate Committee on Finance).

[22] The LUST Trust Fund financing rate also is extended through September 30, 2016. The provision also corrects a potential drafting ambiguity regarding the taxable period as reflected in prior legislation. The provision is effective as if included in section 142 of the Surface Transportation Extension Act of 2011, Part II.

2. Transfer from Leaking Underground Storage Tank Trust Fund to Highway Trust Fund (sec. 40201 of the Act, and sec. 9503 and 9508 of the Code)

Present Law

Leaking Underground Storage Tank Trust Fund financing rate

Fuels of a type subject to other trust fund excise taxes generally are subject to an add-on excise tax of 0.1-cent-per-gallon to fund the Leaking Underground Storage Tank ("LUST") Trust Fund.[23] For example, the LUST excise tax applies to gasoline, diesel fuel, kerosene, and most alternative fuels subject to highway and aviation fuels excise taxes, and to fuels subject to the inland waterways fuel excise tax. This excise tax is imposed on both uses and parties subject to the other taxes, and to situations (other than export) in which the fuel otherwise is tax-exempt. For example, off-highway business use of gasoline and off-highway use of diesel fuel and kerosene generally are exempt from highway motor fuels excise tax. Similarly, States and local governments and certain other parties are exempt from such tax. Nonetheless, all such uses and parties are subject to the 0.1-cent-per-gallon LUST excise tax.

Liquefied natural gas, compressed natural gas, and liquefied petroleum gas are exempt from the LUST tax. Additionally, methanol and ethanol fuels produced from coal (including peat) are taxed at a reduced rate of 0.05 cents per gallon.

The LUST tax is scheduled to expire after June 30, 2012.[24]

Overview of Leaking Underground Storage Tank Trust Fund expenditure provisions

Amounts in the LUST Trust Fund are available, as provided in appropriations Acts, for purposes of making expenditures to carry out sections 9003(h)–(j), 9004(f), 9005(c), and 9010–9013 of the Solid Waste Disposal Act as in effect on the date of enactment of Public Law 109–168. Any claim filed against the LUST Trust Fund may be paid only out of such fund, and the liability of the United States for claims is limited to the amount in the fund.

The monies in the LUST Trust Fund are used to pay expenses incurred by the Environmental Protection Agency (the "EPA") and the States for preventing, detecting, and cleaning up leaks from petroleum underground storage tanks, as well as programs to evaluate the compatibility of fuel storage tanks with alternative fuels, MTBE additives, and ethanol and biodiesel blends.

The EPA makes grants to States to implement the program, and States use cleanup funds primarily to oversee and enforce corrective actions by responsible parties. States and EPA also use cleanup funds to conduct corrective actions where no responsible party has been identified, where a responsible party fails to comply with a cleanup order, in the event of an emergency, and to take cost recovery actions against parties. In 2005, Congress authorized the EPA and States to use trust fund monies for non-cleanup purposes

[23] Secs. 4041, 4042, and 4081.

[24] For Federal budget scorekeeping purposes, the LUST Trust Fund tax, like other excise taxes dedicated to trust funds, is assumed to be permanent.

as well, specifically for administration and enforcement of the leak prevention requirements of the UST program.[25]

Reasons for Change[26]

Revenues deposited in the LUST Trust Fund have exceeded outlays and the Fund has a surplus balance. The Highway Trust Fund primarily relies on motor fuel excise taxes for its revenues. Congress believes that since the LUST tax is collected on motor fuels, it is appropriate to fund highway projects with a portion of such motor fuel tax receipts.

Explanation of Provision

The provision transfers $2.4 billion from the LUST Trust Fund to the Highway Account of the Highway Trust Fund.

Effective Date

The provision is effective on the date of enactment.

3. Pension funding stabilization (sec. 40211 of the Act, sec. 430 of the Code, and secs. 101(f) and 303 of ERISA)

Present Law

Minimum funding rules

Defined benefit plans are subject to minimum funding rules that generally require the sponsoring employer to make a certain level of contribution for each plan year to fund plan benefits.[27] Parallel rules apply under the Employee Retirement Income Security Act of 1974 ("ERISA"), which is generally in the jurisdiction of the Department of Labor.[28] The minimum funding rules for single-employer defined benefit plans were substantially revised by the Pension Protection Act of 2006 ("PPA").[29]

Minimum required contributions

In general

The minimum required contribution for a plan year for a single-employer defined benefit plan generally depends on a comparison of the value of the plan's assets, reduced by any prefunding balance or funding standard carryover balance ("net value of plan as-

[25] Pub. L. No. 109–58.

[26] See S. Rep. 112–152 (February 27, 2012) at 13.

[27] Sec. 412. A number of exceptions to the minimum funding rules apply. For example, governmental plans (within the meaning of section 414(d)) and church plans (within the meaning of section 414(e)) are generally not subject to the minimum funding rules. Under section 4971, an excise tax applies to an employer maintaining a single-employer plan if the minimum funding requirements are not satisfied.

[28] Sec. 302 of ERISA.

[29] Pub. L. No. 109–280. The PPA minimum funding rules for single-employer plans are generally effective for plan years beginning after December 31, 2007. Delayed effective dates apply to single-employer plans sponsored by certain large defense contractors, multiple-employer plans of some rural cooperatives, eligible charity plans, and single-employer plans affected by settlement agreements with the Pension Benefit Guaranty Corporation. Subsequent changes to the single-employer plan and multiemployer plan funding rules (including temporary funding relief) were made by the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"), Pub. L. No. 110–458, and the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 ("PRA 2010"), Public Law 111–192.

sets"),[30] with the plan's funding target and target normal cost. The plan's funding target for a plan year is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is generally the present value of benefits expected to accrue or to be earned during the plan year.

If the net value of plan assets is less than the plan's funding target, so that the plan has a funding shortfall (discussed further below), the minimum required contribution is the sum of the plan's target normal cost and the shortfall amortization charge for the plan year (determined as described below).[31] If the net value of plan assets is equal to or exceeds the plan's funding target, the minimum required contribution is the plan's target normal cost, reduced by the amount, if any, by which the net value of plan assets exceeds the plan's funding target.

Shortfall amortization charge

The shortfall amortization charge for a plan year is the sum of the annual shortfall amortization installments attributable to the shortfall bases for that plan year and the six previous plan years. Generally, if a plan has a funding shortfall for the plan year, a shortfall amortization base must be established for the plan year.[32] A plan's funding shortfall is the amount by which the plan's funding target exceeds the net value of plan assets. The shortfall amortization base for a plan year is: (1) the plan's funding shortfall, minus (2) the present value, determined using the segment interest rates (discussed below), of the aggregate total of the shortfall amortization installments that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases for the six previous plan years. The shortfall amortization base is amortized in level annual installments ("shortfall amortization installments") over a seven-year period beginning with the current plan year and using the segment interest rates (discussed below).[33]

The shortfall amortization base for a plan year may be positive or negative, depending on whether the present value of remaining installments with respect to amortization bases for previous years is more or less than the plan's funding shortfall. If the shortfall

[30] The value of plan assets is generally reduced by any prefunding balance or funding standard carryover balance in determining minimum required contributions. A prefunding balance results from contributions to a plan that exceed the minimum required contributions. A funding standard carryover balance results from a positive balance in the funding standard account that applied under the funding requirements in effect before PPA. Subject to certain conditions, a prefunding balance or funding standard carryover balance may be credited against the minimum required contribution for a year, reducing the amount that must be contributed.

[31] If the plan has obtained a waiver of the minimum required contribution (a funding waiver) within the past five years, the minimum required contribution also includes the related waiver amortization charge, that is, the annual installment needed to amortize the waived amount in level installments over the five years following the year of the waiver.

[32] If the value of plan assets, reduced only by any prefunding balance if the employer elects to apply the prefunding balance against the required contribution for the plan year, is at least equal to the plan's funding target, no shortfall amortization base is established for the year.

[33] Under PRA 2010, employers were permitted to elect to use one of two alternative extended amortization schedules for up to two "eligible" plan years during the period 2008–2011. The use of an extended amortization schedule has the effect of reducing the amount of the shortfall amortization installments attributable to the shortfall amortization base for the eligible plan year. However, the shortfall amortization installments attributable to an eligible plan year may be increased by an additional amount, an "installment acceleration amount," in the case of employee compensation exceeding $1 million, extraordinary dividends, or stock redemptions within a certain period of the eligible plan year.

amortization base is positive (that is, the funding shortfall exceeds the present value of the remaining installments), the related shortfall amortization installments are positive. If the shortfall amortization base is negative, the related shortfall amortization installments are negative. The positive and negative shortfall amortization installments for a particular plan year are netted when adding them up in determining the shortfall amortization charge for the plan year, but the resulting shortfall amortization charge cannot be less than zero (i.e., negative amortization installments may not offset normal cost).

If the net value of plan assets for a plan year is at least equal to the plan's funding target for the year, so the plan has no funding shortfall, any shortfall amortization bases and related shortfall amortization installments are eliminated.[34] As indicated above, if the net value of plan assets exceeds the plan's funding target, the excess is applied against target normal cost in determining the minimum required contribution.

Interest rate used to determine target normal cost and funding target

The minimum funding rules for single-employer plans specify the interest rates and other actuarial assumptions that must be used in determining the present value of benefits for purposes of a plan's target normal cost and funding target.

Present value is determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period. The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year; the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period. Each segment rate is a single interest rate determined monthly by the Secretary of the Treasury ("Secretary") on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. The corporate bond yield curve used for this purpose reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. The Internal Revenue Service (IRS) publishes the segment rates each month.

The present value of liabilities under a plan is determined using the segment rates for the "applicable month" for the plan year. The applicable month is the month that includes the plan's valuation date for the plan year, or, at the election of the employer, any of the four months preceding the month that includes the valuation date.

Solely for purposes of determining minimum required contributions, in lieu of the segment rates described above, an employer may elect to use interest rates on a yield curve based on the yields

[34] Any amortization base relating to a funding waiver for a previous year is also eliminated.

on investment grade corporate bonds for the month preceding the month in which the plan year begins (i.e., without regard to the 24-month averaging described above) ("monthly yield curve"). If an election to use a monthly yield curve is made, it cannot be revoked without IRS approval.

Use of segment rates for other purposes

In general

In addition to being used to determine a plan's funding target and target normal cost, the segment rates are used also for other purposes, either directly because the segment rates themselves are specifically cross-referenced or indirectly because funding target, target normal cost, or some other concept, such as funding target attainment percentage (discussed below) in which funding target or target normal cost is an element, is cross-referenced elsewhere.

Funding target attainment percentage

A plan's funding target attainment percentage for a plan year is the ratio, expressed as a percentage, that the net value of plan assets bears to the plan's funding target for the year. Special rules may apply to a plan if its funding target attainment percentage is below a certain level. For example, funding target attainment percentage is used to determine whether a plan is in "at-risk" status, so that special actuarial assumptions ("at-risk assumptions") must be used in determining the plan's funding target and target normal cost.[35] A plan is in at risk status for a plan year if, for the preceding year: (1) the plan's funding target attainment percentage, determined without regard to the at-risk assumptions, was less than 80 percent, and (2) the plan's funding target attainment percentage, determined using the at-risk assumptions (without regard to whether the plan was in at-risk status for the preceding year), was less than 70 percent.[36] In addition, as discussed below, special reporting to the Pension Benefit Guaranty Corporation ("PBGC") may be required if a plan's funding target attainment percentage is less than 80 percent.

Restrictions on benefit increases, certain types of benefits and benefit accruals (collectively referred to as "benefit restrictions") may apply to a plan if the plan's adjusted funding target attainment percentage is below a certain level.[37] Adjusted funding target attainment percentage is determined in the same way as funding target attainment percentage, except that the net value of plan assets and the plan's funding target are both increased by the aggregate amount of purchases of annuities for employees, other than highly compensated employees, made by the plan during the two preceding plan years. Although anti-cutback rules generally prohibit reductions in benefits that have already been earned under a

[35] If a plan is in at-risk status, under section 409A(b)(3), limitations apply on the employer's ability to set aside assets to provide benefits under a nonqualified deferred compensation plan.

[36] A similar test applies in order for an employer to be permitted to apply a prefunding balance against its required contribution, that is, for the preceding year, the ratio of the value of plan assets (reduced by any prefunding balance) must be at least 80 percent of the plan's funding target (determined without regard to the at-risk rules).

[37] Code sec. 436 and ERISA sec. 206(g).

plan,[38] reductions required to comply with the benefit restrictions are permitted.

Minimum and maximum lump sums, limits on deductible contributions, retiree health

Defined benefit plans commonly allow a participant to choose among various forms of benefit offered under the plan, such as a lump-sum distribution. These optional forms of benefit generally must be actuarially equivalent to the life annuity benefit payable to the participant at normal retirement age. For certain forms of benefit, such as lump sums, the benefit amount cannot be less than the amount determined using the segment rates and a specified mortality table.[39] For this purpose, however, the segment rates are determined on a monthly basis, rather than using a 24-month average of corporate bond rates.

The amount of benefits under a defined benefit plan are subject to certain limits.[40] The segment rates used in determining minimum lump sums (and certain other forms of benefit) are also used in applying the benefit limits to lump sums, i.e., "maximum" lump sums (and the certain other forms of benefit).

Limits apply to the amount of plan contributions that may be deducted by an employer.[41] In the case of a single-employer defined benefit plan, the plan's funding target and target normal cost, determined using the segment rates that apply for funding purposes, are taken into account in calculating the limit on deductible contributions.

Subject to various conditions, a qualified transfer of excess assets of a single-employer defined benefit plan to a retiree medical account within the plan may be made in order to fund retiree health benefits.[42] For this purpose, excess assets generally means the excess, if any, of the value of the plan's assets over 125 percent of the sum of the plan's funding target and target normal cost for the plan year.

PBGC premiums and 4010 reporting

PBGC premiums apply with respect to defined benefit plans covered by ERISA.[43] In the case of a single-employer defined benefit plan, flat-rate premiums apply at a rate of $35.00 per participant for 2012.[44] If a single-employer defined benefit plan has unfunded vested benefits, variable-rate premiums also apply at a rate of $9 per $1,000 of unfunded vested benefits divided by the number of participants. For purposes of determining variable-rate premiums, unfunded vested benefits are equal to the excess (if any) of (1) the plan's funding target for the year determined as under the minimum funding rules, but taking into account only vested benefits, over (2) the fair market value of plan assets. In determining the plan's funding target for this purpose, the interest rates used are

[38] Code sec. 411(d)(6) and ERISA sec. 204(g).
[39] Code sec. 417(e) and ERISA sec. 205(g).
[40] Sec. 415(b).
[41] Sec. 404.
[42] Sec. 420. Under present law, a qualified transfer is not permitted after December 31, 2013.
[43] ERISA sec. 4006.
[44] Flat-rate premiums apply also to multiemployer defined benefit plans at a rate of $9.00 per participant. Single-employer and multiemployer flat-rate premium rates are indexed for inflation. The rate of variable-rate premiums is not indexed.

segment rates determined as under the minimum funding rules, but determined on a monthly basis, rather than using a 24-month average of corporate bond rates.

In certain circumstances, the contributing sponsor of a single-employer plan defined benefit pension plan covered by the PBGC (and members of the contributing sponsor's controlled group) must provide certain information to the PBGC (referred to as "section 4010 reporting").[45] This information includes actuarial information with respect to single-employer plans maintained by the contributing sponsor (and controlled group members). Section 4010 reporting is required if: (1) the funding target attainment percentage at the end of the preceding plan year of a plan maintained by the contributing sponsor or any member of its controlled group is less than 80 percent; (2) the conditions for imposition of a lien (i.e., required contributions totaling more than $1 million have not been made) have occurred with respect to a plan maintained by the contributing sponsor or any member of its controlled group; or (3) minimum funding waivers in excess of $1 million have been granted with respect to a plan maintained by the contributing sponsor or any member of its controlled group and any portion of the waived amount is still outstanding.

Annual funding notice

The plan administrator of a defined benefit plan must provide an annual funding notice to: (1) each participant and beneficiary; (2) each labor organization representing such participants or beneficiaries; and (4) the PBGC.[46]

In addition to the information required to be provided in all funding notices, certain information must be provided in the case of a single-employer defined benefit plan, including:

- a statement as to whether the plan's funding target attainment percentage (as defined under the minimum funding rules) for the plan year to which the notice relates and the two preceding plan years, is at least 100 percent (and, if not, the actual percentages); and
- a statement of (a) the total assets (separately stating any funding standard carryover or prefunding balance) and the plan's liabilities for the plan year and the two preceding years, determined in the same manner as under the funding rules, and (b) the value of the plan's assets and liabilities as of the last day of the plan year to which the notice relates, determined using fair market value and the interest rate used in determining variable rate premiums.

A funding notice may also include any additional information that the plan administrator elects to include to the extent not inconsistent with regulations. The notice must be written so as to be understood by the average plan participant. As required under PPA, the Secretary of Labor has issued a model funding notice that can be used to satisfy the notice requirement.

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[45] ERISA sec. 4010.

[46] ERISA sec. 101(f). In the case of a multiemployer plan, the notice must also be sent to each employer that has an obligation to contribute under the plan.

Explanation of Provision

The provision revises the rules for determining the segment rates under the single-employer plan funding rules by adjusting a segment rate if the rate determined under the regular rules is outside a specified range of the average of the segment rates for the preceding 25-year period ("average" segment rates). In particular, if a segment rate determined for an applicable month under the regular rules is less than the applicable minimum percentage, the segment rate is adjusted upward to match that percentage. If a segment rate determined for an applicable month under the regular rules is more than the applicable maximum percentage, the segment rate is adjusted downward to match that percentage. For this purpose, the average segment rate is the average of the segment rates determined under the regular rules for the 25-year period ending September 30 of the calendar year preceding the calendar year in which the plan year begins. The Secretary is to determine average segment rates on an annual basis and may prescribe equivalent rates for any years in the 25-year period for which segment rates determined under the regular rules are not available. The Secretary is directed to publish the average segment rates each month.

The applicable minimum percentage and the applicable maximum percentage depend on the calendar year in which the plan year begins as shown by the following table:

If the calendar year is:	The applicable minimum percentage is:	The applicable maximum percentage is:
2012	90 percent	110 percent
2013	85 percent	115 percent
2014	80 percent	120 percent
2015	75 percent	125 percent
2016 or later	70 percent	130 percent

Thus, for example, if the first segment rate determined for an applicable month under the regular rules for a plan year beginning in 2012 is less than 90 percent of the average of the first segment rates determined under the regular rules for the 25-year period ending September 30, 2011, the segment rate is adjusted to 90 percent of the 25-year average.

Under the provision, if, as of the date of enactment, an employer election is in effect to use a monthly yield curve in determining minimum required contributions, rather than segment rates, the employer may revoke the election (and use segment rates, as modified by the provision) without obtaining IRS approval. The revocation must be made at any time before the date that is one year after the date of enactment, and the revocation will be effective for the first plan year to which the amendments made by the provision apply and all subsequent plan years. The employer is not precluded from making a subsequent election to use a monthly yield curve in determining minimum required contributions in accordance with present law.

The change in the method of determining segment rates under the provision generally applies for the purposes for which segment rates are used under present law, except for purposes of minimum and maximum lump-sum benefits,[47] limits on deductible contributions to single-employer defined benefit plans, qualified transfers of excess pension assets to retiree medical accounts,[48] PBGC variable-rate premiums,[49] and 4010 reporting to the PBGC.

Annual funding notice

The provision requires additional information to be included in the annual funding notice in the case of an applicable plan year. For this purpose, an applicable plan year is any plan year beginning after December 31, 2011, and before January 1, 2015, for which (1) the plan's funding target, determined using segment rates as adjusted to reflect average segment rates ("adjusted" segment rates), is less than 95 percent of the funding target determined without regard to adjusted segment rates (that is, segment rates determined without regard to the provision), (2) the plan has a funding shortfall, determined without regard to adjusted segment rates, greater than $500,000 and (3) the plan had 50 or more participants on any day during the preceding plan year.

The additional information that must be provided is:

- a statement that MAP–21 modified the method for determining the interest rates used to determine the actuarial value of benefits earned under the plan, providing for a 25-year average of interest rates to be taken into account in addition to a 2-year average;
- a statement that, as a result of MAP–21, the plan sponsor may contribute less money to the plan when interest rates are at historical lows, and
- a table showing, for the applicable plan year and each of the two preceding plan years, the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution, each determined both using adjusted segment rates and without regard to adjusted segment rates (that is, as under present law). In the case of a preceding plan year beginning before January 1, 2012, only the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution provided determined without regard to adjusted segment rates (that is, determined as under present law before enactment of the provision) are required to be provided.

As under present law, a funding notice may also include any additional information that the plan administrator elects to include to the extent not inconsistent with regulations. For example, a funding notice may include a statement of the amount of the employer's actual or planned contributions to the plan.

[47] The provision does not provide a specific exception for determining maximum lump sum benefits. However, because the interest rates used in determining minimum lump sums apply also in determining maximum lump sums, the exception for minimum lump sums applies indirectly to maximum lump sums.

[48] Sections 40241 and 40242 of the Act extend to December 31, 2021, the ability to make a qualified transfer and allow qualified transfers to be made to provide group-term life insurance benefits. See Part One, Section C.4, below.

[49] Sections 40221 and 40222 of the Act revise PBGC flat-rate and variable-rate premiums. See Conference Report to accompany H.R. 4348, the Moving Ahead for Progress in the 21st Century Act, H.R. Rep. No. 112–557, June 28, 2012, pp. 662–663, for an explanation of the PBGC premium changes.

The Secretary of Labor is directed to modify the model funding notice required so that the model includes the additional information in a prominent manner, for example, on a separate first page before the remainder of the notice.

Effective Date

The provision is generally effective for plan years beginning after December 31, 2011. Under a special rule, an employer may elect, for any plan year beginning before January 1, 2013, not to have the provision apply either (1) for all purposes for which the provision would otherwise apply, or (2) solely for purposes of determining the plan's adjusted funding target attainment percentage (used in applying the benefit restrictions) for that year. A plan is not treated as failing to meet the requirements of the anti-cutback rules solely by reason of an election under the special rule.

4. Transfer of excess pension assets (secs. 40241 and 40242 of the Act and sec. 420 of the Code)

Present Law

Defined benefit pension plan reversions

Defined benefit plan assets generally may not revert to an employer prior to termination of the plan and satisfaction of all plan liabilities.[50] Upon plan termination, the accrued benefits of all plan participants are required to be 100-percent vested. A reversion prior to plan termination may constitute a prohibited transaction and may result in plan disqualification. Any assets that revert to the employer upon plan termination are includible in the gross income of the employer and subject to an excise tax. The excise tax rate is 20 percent if the employer maintains a replacement plan or makes certain benefit increases in connection with the termination; if not, the excise tax rate is 50 percent.

Retiree medical accounts

A defined benefit plan may provide medical benefits to retired employees through a separate account that is part of the plan ("retiree medical accounts").[51] Medical benefits provided through a retiree medical account are generally not includible in the retired employee's gross income.[52]

Transfers of excess pension assets

In general

A qualified transfer of excess assets of a defined benefit plan, including a multiemployer plan,[53] to a retiree medical account within the plan may be made in order to fund retiree health benefits.[54] A qualified transfer does not result in plan disqualification, is not a prohibited transaction, and is not treated as a reversion. Thus,

[50] In addition, a revision may occur only if the terms of the plan so provide.
[51] Sec. 401(h) and Treas. Reg. sec. 1.401–1(b).
[52] Treas. Reg. sec. 1.72–15(h).
[53] The Pension Protection Act of 2006 ("PPA"), Pub. L. No. 109–280, extended the application of the rules for qualified transfers to multiemployer plans with respect to transfers made in taxable years beginning after December 31, 2006.
[54] Sec. 420.

transferred assets are not includible in the gross income of the employer and are not subject to the excise tax on reversions. No more than one qualified transfer may be made in any taxable year. No qualified transfer may be made after December 31, 2013.

Excess assets generally means the excess, if any, of the value of the plan's assets[55] over 125 percent of the sum of the plan's funding target and target normal cost for the plan year. In addition, excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. No deduction is allowed to the employer for (1) a qualified transfer, or (2) the payment of qualified current retiree health liabilities out of transferred funds (and any income thereon). In addition, no deduction is allowed for amounts paid other than from transferred funds for qualified current retiree health liabilities to the extent such amounts are not greater than the excess of (1) the amount transferred (and any income thereon), over (2) qualified current retiree health liabilities paid out of transferred assets (and any income thereon). An employer may not contribute any amount to a health benefits account or welfare benefit fund with respect to qualified current retiree health liabilities for which transferred assets are required to be used.

Transferred assets (and any income thereon) must be used to pay qualified current retiree health liabilities for the taxable year of the transfer. Transferred amounts generally must benefit pension plan participants, other than key employees, who are entitled upon retirement to receive retiree medical benefits through the separate account. Retiree health benefits of key employees may not be paid out of transferred assets.

Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned to the general assets of the plan. These amounts are not includible in the gross income of the employer, but are treated as an employer reversion and are subject to a 20-percent excise tax.

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer (or in the case of a participant who separated in the one-year period ending on the date of the transfer, immediately before the separation).

In order for a transfer to be qualified, a maintenance of effort requirement applies, under which the employer generally must maintain retiree health benefits at the same cost level for the taxable year of the transfer and the following four years.

In addition, the Employee Retirement Income Security Act of 1974 ("ERISA")[56] provides that, at least 60 days before the date of a qualified transfer, the employer must notify the Secretary of Labor, the Secretary of the Treasury, employee representatives, and the plan administrator of the transfer, and the plan adminis-

[55] The value of plan assets for this purpose is the lesser of fair market value or actuarial value, reduced by any prefunding balance or standard carryover balance.

[56] Pub. L. No. 93–406.

trator must notify each plan participant and beneficiary of the transfer.[57]

Qualified future transfers and collectively bargained transfers

If certain requirements are satisfied, transfers of excess pension assets under a single-employer plan to retiree medical accounts to fund the expected cost of retiree medical benefits are permitted for the current and future years (a "qualified future transfer") and such transfers are also allowed in the case of benefits provided under a collective bargaining agreement (a "collectively bargained transfer").[58] Transfers must be made for at least a two-year period. An employer can elect to make a qualified future transfer or a collectively bargained transfer rather than a qualified transfer. A qualified future transfer or collectively bargained transfer must meet the requirements applicable to qualified transfers with modifications related to: (1) the determination of excess pension assets; (2) the limitation on the amount transferred; and (3) the maintenance of effort requirement. The general sunset applicable to qualified transfers applies (i.e., no transfers can be made after December 31, 2013).

Employer provided group-term life insurance

Group-term life insurance coverage provided under a policy carried by an employer is includible in the gross income of an employee (including a former employee) but only to the extent that the cost exceeds the sum of the cost of $50,000 of such insurance plus the amount, if any, paid by the employee toward the purchase of such insurance.[59] Special rules apply for determining the cost of group-term life insurance that is includible in gross income under a discriminatory group-term life insurance plan.

A pension plan may provide life insurance benefits for employees (including retirees) but only to the extent that the benefits are incidental to the retirement benefits provided under the plan.[60] The cost of term life insurance provided through a pension plan is includible in the employee's gross income.[61]

Explanation of Provision

Extension of existing provisions

The Act allows qualified transfers, qualified future transfers, and collectively bargained transfers to retiree medical accounts to be made through December 31, 2021. No transfers are permitted after that date.

Transfers to fund retiree group-term life insurance permitted

The Act allows qualified transfers, qualified future transfers, and collectively bargained transfers to be made to fund the purchase of retiree group-term life insurance. The assets transferred for the

[57] ERISA sec. 101(e). ERISA also provides that a qualified transfer is not a prohibited transaction under ERISA or a prohibited reversion.
[58] The rules for qualified future transfers and collectively bargained transfers were added by the PPA and apply to transfers after the date of enactment (August 17, 2006).
[59] Sec. 79.
[60] Treas. Reg. sec. 1.401–1(b).
[61] Secs. 72(m)(3) and 79(b)(3).

purchase of group-term life insurance must be maintained in a separate account within the plan ("retiree life insurance account"), which must be separate both from the assets in the retiree medical account and from the other assets in the defined benefit plan.

Under the Act, the general rule that the cost of group-term life insurance coverage provided under a defined benefit plan is includable in gross income of the participant does not apply to group-term life insurance provided through a retiree life insurance account. Instead, the general rule for determining the amount of employer-provided group-term life insurance that is includible in gross income applies. However, group-term life insurance coverage is permitted to be provided through a retiree life insurance account only to the extent that it is not includible in gross income. Thus, generally, only group-term life insurance not in excess of $50,000 may be purchased with such transferred assets.

Generally, the present law rules for transfers of excess pension assets to retiree medical accounts to fund retiree health benefits also apply to transfers to retiree life insurance accounts to fund retiree group-term life. However, generally, the rules are applied separately. Thus, for example, the one-transfer-a-year rule generally applies separately to transfers to retiree life insurance accounts and transfers to retiree medical accounts. Further, the maintenance of effort requirement for qualified transfers applies separately to life insurance benefits and health benefits. Similarly, for qualified future transfers and collectively bargained transfers for retiree group-term life insurance, the maintenance of effort and other special rules are applied separately to transfers to retiree life insurance accounts and retiree medical accounts.

Reflecting the inherent differences between life insurance coverage and health coverage, certain rules are not applied to transfers to retiree life insurance accounts, such as the special rules allowing the employer to elect to the determine the applicable employer cost for health coverage during the cost maintenance period separately for retirees eligible for Medicare and retirees not eligible for Medicare. However, a separate test is allowed for the cost of retiree group-term life insurance for retirees under age 65 and those retirees who have reached age 65.

The Act makes other technical and conforming changes to the rules for transfers to fund retiree health benefits and removes certain obsolete ("deadwood") rules.

The same sunset applicable to qualified transfers, qualified future transfers, and collectively bargained transfers to retiree medical accounts applies to transfers to retiree life insurance accounts (i.e., no transfers can be made after December 31, 2021).

Effective Date

The provision applies to transfers made after the date of enactment.

5. Additional transfers to the Highway Trust Fund (sec. 40251 of the Act and sec. 9503 of the Code)

Present Law

Public Law No. 111–46, an Act to restore funds to the Highway Trust Fund, provided that out of money in the Treasury not otherwise appropriated, $7 billion was appropriated to the Highway Trust Fund effective August 7, 2009. The Hiring Incentives to Restore Employment Act (the "HIRE Act") provided that out of money in the Treasury not otherwise appropriated, $14,700,000,000 is appropriated to the Highway Trust Fund and $4,800,000,000 is appropriated to the Mass Transit Account in the Highway Trust Fund.

Explanation of Provision

The Act provides that out of money in the Treasury not otherwise appropriated, the following transfers are to be made from the General Fund to the Highway Trust Fund:

	FY 2013	FY 2014
Highway Account	$6.2 billion	$10.4 billion
Mass Transit Account	....	2.2 billion

Effective Date

The provision is effective on the date of enactment.

6. Exception from early distribution tax for annuities under phased retirement program (sec. 100121(c) of the Act and sec. 72(t) of the Code)

Present Law

The Code imposes an early distribution tax on distributions made from qualified retirement plans before an employee attains age 59½.[62] The tax is equal to 10 percent of the amount of the distribution that is includible in gross income. The 10-percent tax is in addition to the taxes that would otherwise be due on distribution. Certain exceptions to the early distribution tax apply including an exception for distributions after separation from service with the employer after attaining age 55, or in the form of substantially equal periodic payments from the qualified retirement plan commencing after separation from service at any age. However, there is no exception for annuity payments that commence before separating from service with the employer.

Explanation of Provision

The Act includes a new Federal Phased Retirement Program under which a Federal agency may allow a full-time retirement eligible employee to elect to enter phased retirement status in accordance with regulations issued by the Office of Personnel Manage-

[62] Sec. 72(t). The early distribution tax also applies to distributions from section 403(b) plans and IRAs but does not apply to distributions from governmental section 457(b) plans.

ment (OPM).[63] During that status, generally, the employee's work schedule is a percentage of a full time work schedule, and the employee receives a phased retirement annuity. At full-time retirement, the phased retiree is entitled to a composite retirement annuity that also includes the portion of the employee's retirement annuity attributable to the reduced work schedule. The Act includes an exception to the early distribution tax for payments under a phased retirement annuity and a composite retirement annuity received by an employee participating in this new Federal Phased Retirement Program.

Effective Date

The provision is effective on the effective date of implementing regulations issued by OPM implementing the Federal Phased Retirement Program.

7. Expand the definition of a tobacco manufacturer to include businesses making available roll-your-own cigarette machines for consumer use (sec. 100122 of the Act and sec. 5702(d) of the Code)

Present Law

Tobacco products and cigarette papers and tubes manufactured in the United States or imported into the United States are subject to Federal excise tax at the following rates:[64]

- Cigars weighing not more than three pounds per thousand ("small cigars") are taxed at the rate of $50.33 per thousand;
- Cigars weighing more than three pounds per thousand ("large cigars") are taxed at the rate equal to 52.75 percent of the manufacturer's or importer's sales price but not more than 40.26 cents per cigar;
- Cigarettes weighing not more than three pounds per thousand ("small cigarettes") are taxed at the rate of $50.33 per thousand ($1.0066 per pack);
- Cigarettes weighing more than three pounds per thousand ("large cigarettes") are taxed at the rate of $105.69 per thousand, except that, if they measure more than six and one-half inches in length, they are taxed at the rate applicable to small cigarettes, counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette;
- Cigarette papers are taxed at the rate of 3.15 cents for each 50 papers or fractional part thereof, except that, if they measure more than six and one-half inches in length, they are taxable by counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette paper;
- Cigarette tubes are taxed at the rate of 6.30 cents for each 50 tubes or fractional part thereof, except that, if they measure more than six and one-half inches in length, they are taxable by counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette tube;

[63] See Conference Report to accompany H.R. 4348, the Moving Ahead for Progress in the 21st Century Act, H.R. Rep. No. 112–557, June 28, 2012, pp. 666–667, for an explanation of the new Federal Phased Retirement Program.
[64] Sec. 5701.

- Snuff is taxed at the rate of $1.51 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of 50.33 cents per pound, and proportionately at that rate on all fractional parts of a pound;
- Pipe tobacco is taxed at the rate of $2.8311 per pound, and proportionately at that rate on all fractional parts of a pound; and
- Roll-your-own tobacco is taxed at the rate of $24.78 per pound, and proportionately at that rate on all fractional parts of a pound.

In general, the excise tax on tobacco products and cigarette papers and tubes manufactured in the United States comes into existence when the products are manufactured and is determined and payable when the tobacco products or cigarette papers and tubes are removed from the bonded premises of the manufacturer. "Tobacco products" means cigars, cigarettes, smokeless tobacco (snuff and chewing tobacco), pipe tobacco, and roll your own tobacco. Processed tobacco is regulated under the internal revenue laws but no excise tax is imposed. Tobacco products and cigarette papers and tubes may be exported from the United States without payment of tax.

Manufacturers and importers of tobacco products or processed tobacco are subject to certain permitting, bonding, reporting, and record keeping requirements. "Manufacturer of tobacco products" means any person who manufactures cigars, cigarettes, smokeless tobacco, pipe tobacco, or roll-your-own tobacco. There is an exception for a person who produces these products for their own personal consumption or use.

Explanation of Provision

The Act amends the definition of manufacturer of tobacco products to include any person who for commercial purposes makes available machines capable of making tobacco products for consumer use. This includes making a machine available for consumers to produce tobacco products for personal consumption or use. The addition of this provision is not intended to change the treatment of such machines under present law. A person who sells a machine directly to a consumer at retail for the consumer's personal home use is not a manufacturer of tobacco products under the provision if the machine is not used at a retail establishment and is designed to produce only personal use quantities.

For purposes of imposing the tax liability, the person making the machine available for consumer use is deemed to be the person making the removal with respect to any tobacco products manufactured by the machine.

Effective Date

The provision is effective for articles removed after the date of enactment (July 6, 2012).

PART TWO: AIRPORT AND AIRWAY TRUST FUND SHORT-TERM EXTENSIONS (PUBLIC LAWS 112–7,[65] 112–16,[66] 112–21,[67] 112–27,[68] 112–30,[69] AND 112–91[70])

Present Law

The Airport and Airway Trust Fund provides funding for capital improvements to the U.S. airport and airway system and funding for the Federal Aviation Administration ("FAA"), among other purposes. The excise taxes imposed to finance the Airport and Airway Trust Fund are:

- ticket taxes imposed on commercial, domestic passenger transportation by air;
- a use of international air facilities tax;
- a cargo tax imposed on freight transportation by air;
- fuels taxes imposed on gasoline used in commercial aviation and noncommercial aviation; and
- fuels taxes imposed on jet fuel (kerosene) and other aviation fuels used in commercial aviation and noncommercial aviation.

In general, except for 4.3 cents of the fuel tax rates, the excise taxes dedicated to the Airport and Airway Trust Fund did not apply after March 31, 2011. Expenditure authority for the Airport and Airway Trust Fund was scheduled to terminate after March 31, 2011.

Explanation of Provisions[71]

Pub. L. No. 112–7 (the "Airport and Airway Extension Act of 2011")

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through May 31, 2011.

[65] H.R. 662. The House passed H.R. 1079 on March 29, 2011. The bill passed the Senate without amendment on March 29, 2011. The President signed the bill on March 31, 2011.

[66] H.R. 1893. The House passed H.R. 1893 on May 23, 2011. The bill passed the Senate without amendment on May 24, 2011. The President signed the bill on May 31, 2011.

[67] H.R. 2779. The House passed H.R. 2779 on Jun 24, 2011. The bill passed the Senate without amendment on June 27, 2011. The President signed the bill on June 29, 2011.

[68] H.R. 2553. The House passed H.R. 2553 on July 20, 2011. The bill passed the Senate without amendment on August 5, 2011. The President signed the bill on August 5, 2011.

[69] H.R. 2887. The House passed H.R. 2887 on September 13, 2011. The bill passed the Senate without amendment on September 15, 2011. The President signed the bill on September 16, 2011.

[70] H.R. 3800. The House passed H.R. 3800 on January 24, 2012. The bill passed the Senate without amendment on January 26, 2012. The President signed the bill on January 31, 2012.

[71] See also Part Nine of this General Explanation for a description of the trust fund and related tax provisions of the "FAA Modernization and Reform Act of 2012" (Pub. L. No. 112–95) which includes a provision that extends the Airport and Airway Trust Fund excise taxes and expenditure authority through September 30, 2015.

Pub. L. No. 112–16 (the "Airport and Airway Extension Act of 2011, Part II")

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through June 30, 2011.

Pub. L. No. 112–21 (the "Airport and Airway Extension Act of 2011, Part III")

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through July 22, 2011.

Pub. L. No. 112–27 (the "Airport and Airway Extension Act of 2011, Part IV")

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through September 16, 2011.

Pub. L. No. 112–30 (the "Surface and Air Transportation Programs Extension Act of 2011, Title II, the "Airport and Airway Extension Act of 2011, Part V," secs. 202–203)

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through January 31, 2012.

Pub. L. No. 112–91 (the "Airport and Airway Extension Act of 2012)

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through February 17, 2012.

PART THREE: COMPREHENSIVE 1099 TAXPAYER PROTECTION AND REPAYMENT OF EXCHANGE SUBSIDY OVERPAYMENTS ACT OF 2011 (PUBLIC LAW 112–9) [72]

A. Repeal of Expansion of Information Reporting Requirements (sec. 2 of the Act and sec. 6041 of the Code)

Present Law

A variety of information reporting requirements apply under present law.[73] The primary provision governing information reporting by payors requires an information return by every person engaged in a trade or business who makes payments to any one payee aggregating $600 or more in any taxable year in the course of that payor's trade or business.[74] Reportable payments include compensation for both goods and services, and may include gross proceeds. Certain enumerated types of payments that are subject to other specific reporting requirements are carved out of reporting under this general rule by regulation.[75] Another carveout excepts payments to corporations from reporting requirements.[76]

For payments made after December 31, 2011, the class of payments subject to reporting was expanded in two ways.[77] First, the regulatory carveout for payments to corporations was expressly overridden by the addition of section 6041(i). In addition, information reporting requirements were expanded to include gross proceeds paid in consideration for any type of property. The payor is required to provide the recipient of the payment with an annual statement showing the aggregate payments made and contact information for the payor.[78] The regulations generally except from reporting payments to exempt organizations, governmental entities, international organizations, or retirement plans.

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[72] H.R. 4. The House Committee on Ways and Means reported H.R. 4 on February 22, 2011 (H.R. Rep. No. 112–15). The House passed H.R. 4 on March 3, 2011. The bill passed the Senate without amendment on April 5, 2011. The President signed the bill on April 14, 2011.

[73] Secs. 6031 through 6060.

[74] Sec. 6041(a). Information returns are generally submitted electronically on Forms 1096 and Forms 1099, although certain payments to beneficiaries or employees may require use of Forms W–3 and W–2, respectively. Treas. Reg. sec. 1.6041–1(a)(2).

[75] Sec. 6041(a) requires reporting of payments "other than payments to which section 6042(a)(1), 6044(a)(1), 6047(c), 6049(a) or 6050N(a) applies and other than payments with respect to which a statement is required under authority of section 6042(a), 6044(a)(2) or 6045[.]" The payments thus excepted include most interest, royalties, and dividends.

[76] Treas. Reg. sec. 1.6041–3(p).

[77] The Patient Protection and Affordable Care Act, Pub. L. No. 111–148, sec. 9006 (March 23, 2010).

[78] Sec. 6041(d). Specifically, the recipient of the payment is required to provide a Form W–9 to the payor, which enables the payee to provide the recipient of the payment with an annual statement showing the aggregate payments made and contact information for the payor. If a Form W–9 is not provided, the payor is required to "backup withhold" tax at a rate of 28 percent of the gross amount of the payment unless the payee has otherwise established that the income is exempt from backup withholding. The backup withholding tax may be credited by the payee against regular income tax liability, i.e., it is effectively an advance payment of tax, similar to the withholding of tax from wages.

Additionally, the requirement that businesses report certain payments is generally not applicable to payments by persons engaged in a passive investment activity. However, beginning in 2011, recipients of rental income from real estate generally are subject to the same information reporting requirements as taxpayers engaged in a trade or business.[79] In particular, rental income recipients making payments of $600 or more to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income are required to provide an information return (typically Form 1099–MISC) to the IRS and to the service provider. Exceptions to this reporting requirement are made for (i) individuals who rent their principal residence on a temporary basis, including members of the military or employees of the intelligence community (as defined in section 121(d)(9)), (ii) individuals who receive only minimal amounts of rental income, as determined by the Secretary in accordance with regulations, and (iii) individuals for whom the requirements would cause hardship, as determined by the Secretary in accordance with regulations.[80]

Detailed rules are provided for the reporting of various types of investment income, including interest, dividends, and gross proceeds from brokered transactions (such as a sale of stock).[81] In general, the requirement to file Form 1099 applies with respect to amounts paid to U.S. persons and is linked to the backup withholding rules of section 3406. Thus, a payor of interest, dividends or gross proceeds generally must request that a U.S. payee (other than certain exempt recipients) furnish a Form W–9 providing that person's name and taxpayer identification number.[82] That information is then used to complete the Form 1099.

Failure to comply with the information reporting requirements results in penalties, which may include a penalty for failure to file the information return,[83] a penalty for failure to furnish payee statements,[84] or failure to comply with other various reporting requirements.[85]

Reasons for Change

Congress understands that there is a significant tax gap, or difference between the amount of tax owed by taxpayers and the amount voluntarily paid to the IRS, that must be addressed. Congress also recognizes that information reporting requirements generally improve taxpayer compliance. However, Congress is concerned that the expansion of the information reporting requirements imposes a substantial tax compliance burden on small businesses, including costs to acquire new software or pay for additional accounting services. Congress believes this burden is disproportionate as compared with any resulting improvement in tax

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[79] Sec. 6041(h); Small Business Jobs Act of 2010, Pub. L. No. 111–240, sec. 2101 (Sept. 27, 2010).

[80] Treasury has not promulgated regulations defining these “minimal amounts of rental income” or “hardship” cases.

[81] Secs. 6042 (dividends), 6045 (broker reporting) and 6049 (interest), as well as the Treasury regulations thereunder.

[82] See Treas. Reg. sec. 31.3406(h)–3.

[83] Sec. 6721.

[84] Sec. 6722.

[85] Sec. 6723.

compliance and therefore believes that these requirements should be repealed in their entirety. Congress will continue to explore other potential solutions to the tax gap problem.

Explanation of Provision

Under the provision, the changes to section 6041 enacted under section 9006 of the Patient Protection and Affordable Care Act that provide rules for payments to corporations, provide additional regulatory authority and impose a reporting requirement with respect to gross proceeds from property, are repealed in their entirety.

Effective Date

This provision is effective for payments made after December 31, 2011.

B. Repeal of Information Reporting Requirements with Respect to Real Estate Expenses (sec. 3 of the Act and sec. 6041 of the Code)

Present Law

A variety of information reporting requirements apply under present law.[86] The primary provision governing information reporting by payors requires an information return by every person engaged in a trade or business who makes payments to any one payee aggregating $600 or more in any taxable year in the course of that payor's trade or business.[87] Reportable payments include compensation for both goods and services, and may include gross proceeds. Certain enumerated types of payments that are subject to other specific reporting requirements are carved out of reporting under this general rule by regulation.[88] Another carveout excepts payments to corporations from reporting requirements.[89]

For payments made after December 31, 2011, the class of payments subject to reporting was expanded in two ways.[90] First, the regulatory carveout for payments to corporations was expressly overridden by the addition of section 6041(i). In addition, information reporting requirements were expanded to include gross proceeds paid in consideration for any type of property. The payor is required to provide the recipient of the payment with an annual statement showing the aggregate payments made and contact information for the payor.[91] The regulations generally except from re-

[86] Secs. 6031 through 6060.

[87] Sec. 6041(a). Information returns are generally submitted electronically on Forms 1096 and Forms 1099, although certain payments to beneficiaries or employees may require use of Forms W–3 and W–2, respectively. Treas. Reg. sec. 1.6041–1(a)(2).

[88] Sec. 6041(a) requires reporting of payments "other than payments to which section 6042(a)(1), 6044(a)(1), 6047(c), 6049(a) or 6050N(a) applies and other than payments with respect to which a statement is required under authority of section 6042(a), 6044(a)(2) or 6045[.]" The payments thus excepted include most interest, royalties, and dividends.

[89] Treas. Reg. sec. 1.6041–3(p).

[90] The Patient Protection and Affordable Care Act, Pub. L. No. 111–148, sec. 9006 (March 23, 2010).

[91] Sec. 6041(d). Specifically, the recipient of the payment is required to provide a Form W–9 to the payor, which enables the payee to provide the recipient of the payment with an annual statement showing the aggregate payments made and contact information for the payor. If a Form W–9 is not provided, the payor is required to "backup withhold" tax at a rate of 28 percent of the gross amount of the payment unless the payee has otherwise established that the income

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porting payments to exempt organizations, governmental entities, international organizations, or retirement plans.

Additionally, the requirement that businesses report certain payments is generally not applicable to payments by persons engaged in a passive investment activity. However, beginning in 2011, recipients of rental income from real estate generally are subject to the same information reporting requirements as taxpayers engaged in a trade or business.[92] In particular, rental income recipients making payments of $600 or more to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income are required to provide an information return (typically Form 1099–MISC) to the IRS and to the service provider. Exceptions to this reporting requirement are made for (i) individuals who rent their principal residence on a temporary basis, including members of the military or employees of the intelligence community (as defined in section 121(d)(9)), (ii) individuals who receive only minimal amounts of rental income, as determined by the Secretary in accordance with regulations, and (iii) individuals for whom the requirements would cause hardship, as determined by the Secretary in accordance with regulations.[93]

Detailed rules are provided for the reporting of various types of investment income, including interest, dividends, and gross proceeds from brokered transactions (such as a sale of stock).[94] In general, the requirement to file Form 1099 applies with respect to amounts paid to U.S. persons and is linked to the backup withholding rules of section 3406. Thus, a payor of interest, dividends or gross proceeds generally must request that a U.S. payee (other than certain exempt recipients) furnish a Form W–9 providing that person's name and taxpayer identification number.[95] That information is then used to complete the Form 1099.

Failure to comply with the information reporting requirements results in penalties, which may include a penalty for failure to file the information return,[96] and a penalty for failure to furnish payee statements[97] or failure to comply with other various reporting requirements.[98]

Reasons for Change[99]

Congress understands that there is a significant tax gap, or difference between the amount of tax owed by taxpayers and the amount voluntarily paid to the IRS, that must be addressed. Congress also recognizes that information reporting requirements gen-

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is exempt from backup withholding. The backup withholding tax may be credited by the payee against regular income tax liability, i.e., it is effectively an advance payment of tax, similar to the withholding of tax from wages.

[92] Sec. 6041(h); Small Business Jobs Act of 2010, Pub. L. No. 111–240, sec. 2101 (Sept. 27, 2010).

[93] Treasury has not promulgated regulations defining these "minimal amounts of rental income" or "hardship" cases.

[94] Secs. 6042 (dividends), 6045 (broker reporting) and 6049 (interest), as well as the Treasury regulations thereunder.

[95] See Treas. Reg. sec. 31.3406(h)–3.

[96] Sec. 6721.

[97] Sec. 6722.

[98] Sec. 6723.

[99] See H.R. 705, The "Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011," which was reported by the House Ways and Means Committee on February 22, 2011, pp. 7–8, H.R. Rep. No. 112–16.

erally improve taxpayer compliance. However, Congress is concerned that the expansion of the information reporting requirements to owners of rental real estate imposes a significant tax compliance burden on taxpayers who are not otherwise engaged in business activity. Congress believes this burden is disproportionate as compared with any resulting improvement in tax compliance and therefore believes that these requirements should be repealed in their entirety. Congress will continue to explore other potential solutions to the tax gap problem.

Explanation of Provision

Under the provision, recipients of rental income from real estate who are not otherwise considered to be engaged in a trade or business of renting property are not subject to the same information reporting requirements as taxpayers who are considered to be engaged in a trade or business. As a result, rental income recipients making payments of $600 or more to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income are not required to provide an information return (typically Form 1099–MISC) to the IRS and to the service provider.

Effective Date

The provision is effective for payments made after December 31, 2010.

C. Increase in Amount of Overpayment of Health Care Credit Which Is Subject to Recapture (sec. 4 of the Act and sec. 36B of the Code)

Present Law

Premium assistance credit

For taxable years ending after December 31, 2013, a refundable tax credit (the "premium assistance credit") is provided for eligible individuals and families who purchase health insurance through an American Health Benefit Exchange. The premium assistance credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans through an American Health Benefit Exchange.

The premium assistance credit is available for individuals (single or joint filers) with household incomes between 100 and 400 percent of the Federal poverty level ("FPL") for the family size involved who are not eligible for certain other health insurance.[100] Household income is defined as the sum of: (1) the taxpayer's modified adjusted gross income, plus (2) the aggregate modified adjusted gross incomes of all other individuals taken into account in determining that taxpayer's family size (but only if such individuals are required to file a tax return for the taxable year). Modified adjusted gross income is defined as adjusted gross income increased by: (1) any amount excluded by section 911 (the exclusion from

[100] Individuals who are lawfully present in the United States but are not eligible for Medicaid because of their immigration status are treated as having a household income equal to 100 percent of FPL (and thus eligible for the premium assistance credit) as long as their household income does not actually exceed 100 percent of FPL.

gross income for citizens or residents living abroad), plus (2) any tax-exempt interest received or accrued during the tax year.[101] To be eligible for the premium assistance credit, taxpayers who are married (within the meaning of section 7703) must file a joint return. Individuals who are listed as dependents on a return are ineligible for the premium assistance credit.

As described in Table 1 below, premium assistance credits are available on a sliding scale basis for individuals and families with household incomes between 100 and 400 percent of FPL to help subsidize the cost of private health insurance premiums. The premium assistance credit amount is determined based on the percentage of income the individual's or family's share of premiums represents, rising from two percent of income for those at 100 percent of FPL for the family size involved to 9.5 percent of income for those at 400 percent of FPL for the family size involved. After 2014, the percentages of income are indexed to the excess of premium growth over income growth for the preceding calendar year. After 2018, if the aggregate amount of premium assistance credits and cost-sharing reductions[102] exceeds 0.504 percent of the gross domestic product for that year, the percentage of income is also adjusted to reflect the excess (if any) of premium growth over the rate of growth in the consumer price index for the preceding calendar year. For purposes of calculating family size, individuals who are in the country illegally are not included.

TABLE 1.—THE PREMIUM ASSISTANCE CREDIT PHASE-OUT

Household income (expressed as a percent of FPL)	Initial premium (percentage)	Final premium (percentage)
100% up to 133%	2.0	2.0
133% up to 150%	3.0	4.0
150% up to 200%	4.0	6.3
200% up to 250%	6.3	8.05
250% up to 300%	8.05	9.5
300% up to 400%	9.5	9.5

Minimum essential coverage and employer offer of health insurance coverage

Generally, if an employee is offered minimum essential coverage[103] in the group market, including employer-provided health insurance coverage, the individual is ineligible for the premium assistance credit for health insurance purchased through an American Health Benefit Exchange.

If an employee's share of the premium for self-only coverage exceeds 9.5 percent of an employee's household income or the plan's share of total allowed cost of provided benefits is less than 60 percent of such costs, the employee can be eligible for the premium assistance credit. Premium assistance tax credit eligibility requires

[101] The definition of modified adjusted gross income used in section 36B is incorporated by reference for purposes of determining eligibility to participate in certain other healthcare-related programs, such as reduced cost-sharing (section 1402 of PPACA), Medicaid for the nonelderly (section 1902(e) of the Social Security Act (42 U.S.C. 1396a(e)) as modified by section 2002(a) of PPACA) and the Children's Health Insurance Program (section 2102(b)(1)(B) of the Social Security Act (42 U.S.C. 1397bb(b)(1)(B)) as modified by section 2101(d) of PPACA).

[102] As described in section 1402 of PPACA.

[103] As defined in section 5000A(f).

that an employee decline enrollment in employer-offered coverage and satisfy the conditions for receiving a premium assistance tax credit through an American Health Benefit Exchange.

Reconciliation

If the premium assistance credit received through advance payment exceeds the amount of premium assistance credit to which the taxpayer is entitled for the taxable year, the liability for the overpayment must be reflected on the taxpayer's income tax return for the taxable year subject to a limitation on the amount of such liability. For persons with household income below 500 percent of FPL, the liability for the overpayment for a taxable year is limited to a specific dollar amount (the "applicable dollar amount") as shown in Table 2 below (one-half of the applicable dollar amount shown in Table 2 for unmarried individuals who are not surviving spouses or filing as heads of households).[104]

TABLE 2.—RECONCILIATION

Household Income (expressed as a percent of FPL)	Applicable Dollar Amount
Less than 200%	$600
At least 200% but less than 250%	$1,000
At least 250% but less than 300%	$1,500
At least 300% but less than 350%	$2,000
At least 350% but less than 400%	$2,500
At least 400% but less than 450%	$3,000
At least 450% but less than 500%	$3,500

If the premium assistance credit for a taxable year received through advance payment is less than the amount of the credit to which the taxpayer is entitled for the year, the shortfall in the credit is also reflected on the taxpayer's tax return for the year.

Reasons for Change[105]

Congress believes that taxpayers with household income of at least 200 percent of FPL but less than 400 percent of FPL should be required to repay a portion of the overpayment of the premium assistance credit received. Congress believes that it is equitable to increase the current repayment rates for these individuals. Furthermore, Congress never intended for a taxpayer with a household income that is 400 percent of FPL or above to be eligible for premium assistance credits. Thus, for any taxpayer with household income that is 400 percent of FPL or above, Congress believes the taxpayer should be required to repay the full amount of any overpayment of the advance premium assistance credit.

[104] Section 36B(f)(2), as amended by section 208 of the Medicare and Medicaid Extenders Act of 2010, Pub. L. No. 111–309. Prior to the Medicare and Medicaid Extenders Act of 2010, for persons whose household income was below 400 percent of the FPL, the amount of the increase in tax was limited to $400 ($250 for unmarried individuals who are not surviving spouses or filing as heads of households).

[105] See H.R. 705, The "Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011," which was reported by the House Ways and Means Committee on February 22, 2011, pp. 7–8, H.R. Rep. No. 112–16.

Explanation of Provision

Under the provision, the applicable dollar amounts with respect to overpayments of advance premium assistance credit for a taxable year are revised as shown in Table 3 below (one half of the applicable dollar amount shown in Table 3 for unmarried individuals who are not surviving spouses or filing as heads of households).[106]

TABLE 3.—RECONCILIATION

Household Income (expressed as a percent of FPL)	Applicable Dollar Amount
Less than 200%	$600
At least 200% but less than 300%	$1,500
At least 300% but less than 400%	$2,500

Persons with household incomes of 400 percent of FPL and above must repay the full amount of the premium assistance credit received through an advance payment.

Effective Date

The provision applies to taxable years ending after December 31, 2013.

[106] As discussed in Part Seven, Section E, the definition of modified adjusted gross income applicable for purposes of the credit was amended by Pub. L. No. 112–56. As amended, modified adjusted gross income is defined as adjusted gross income increased by: (1) any amount excluded by section 911 (the exclusion from gross income for citizens or residents living abroad), (2) any tax-exempt interest received or accrued during the tax year, and (3) an amount equal to the portion of the taxpayer's Social Security benefits (as defined in section 86(d)) that is excluded from income under section 86 (that is, the amount of the taxpayer's Social Security benefits that are excluded from gross income).

PART FOUR: REVENUE PROVISION OF THE DEPARTMENT OF DEFENSE AND FULL-YEAR CONTINUING APPROPRIATIONS ACT OF 2011 (PUBLIC LAW 112–10) [107]

A. Free Choice Vouchers (sec. 1858 of the Act and secs. 36B, 139D and 4980H of the Code)

Present Law

Employers offering minimum essential coverage through an eligible employer-sponsored plan and paying a portion of that coverage must provide qualified employees with a voucher ("free choice voucher") whose value can be applied to purchase of a health plan through an American Health Benefit Exchange.[108] Qualified employees are employees whose required contribution for employer-sponsored minimum essential coverage exceeds eight percent, but does not exceed 9.8 percent of the employee's household income for the taxable year [109] and the employee's total household income does not exceed 400 percent of the poverty line for the family. In addition, the employee must not participate in the employer's health plan.

The value of the voucher is equal to the dollar value of the employer contribution to the employer offered health plan. If multiple plans are offered by the employer, the value of the voucher is the dollar amount that would be paid if the employee chose the plan for which the employer would pay the largest percentage of the premium cost.[110] The value of the voucher is for self-only coverage unless the individual purchases family coverage in the American Health Benefit Exchange. For purposes of calculating the dollar value of the employer contribution, the premium for any health plan is determined under rules similar to the rules for determining the "applicable premium" for purposes of the continuation coverage requirements under the Public Health Service Act ("PHSA"),[111] except that the amount is adjusted for age and category of enrollment in accordance with regulations established by the Secretary.

[107] H.R. 1473. The House passed H.R. 1473 on April 14, 2011. The bill passed the Senate without amendment on April 14, 2011. The President signed the bill on April 15, 2011.

[108] Section 10108 of PPACA.

[109] In the case of years after 2014, the eight percent and the 9.8 percent are indexed to reflect the excess of premium growth over income growth.

[110] For example, if an employer offering the same plans for $200 and $300 offers a flat $180 contribution for all plans, a contribution of 90 percent for the $200 plan and a contribution of 60 percent for the $300 plan, and the value of the voucher would equal the value of the contribution to the $200 plan since it received a 90 percent contribution, a value of $180. However, if the firm offers a $150 contribution to the $200 plan (75 percent) and a $200 contribution to the $300 plan (67 percent), the value of the voucher is based on the plan receiving the greater percentage paid by the employer and would be $150. If a firm offers health plans with monthly premiums of $200 and $300 and provides a payment of 60 percent of any plan purchased, the value of the voucher will be 60 percent the higher premium plan, in this case, 60 percent of $300 or $180.

[111] Sec. 2204 of the PHSA, 42 U.S.C. 300bb–4.

Vouchers can be used in the American Health Benefit Exchange towards the monthly premium of any qualified health plan in the American Health Benefit Exchange. The value of the voucher to the extent it is used for the purchase of a health plan is not includable in gross income.[112] If the value of the voucher exceeds the premium of the health plan chosen by the employee, the employee is paid the excess value of the voucher. The excess amount received by the employee is includible in the employee's gross income.

If an individual receives a voucher, the individual is disqualified from receiving any premium assistance tax credit or reduced cost-sharing credit with respect to a plan purchased through the American Health Benefit Exchange.[113] Similarly, if an employee receives a free choice voucher, the employee's employer is not assessed an employer responsibility payment with respect to that employee.[114]

Explanation of Provision

The provision repeals the statutory provisions relating to free choice vouchers.

Effective Date

The provision is effective as if included in the provisions of, and the amendments made by, the provisions of PPACA to which they relate.

[112] Sec. 139D.
[113] Sec. 36B and section 1402 of PPACA.
[114] Sec. 4980H(b)(3). Under section 6056, employers are required to provide information relating to costs paid under their health plans.

PART FIVE: REVENUE PROVISIONS OF THE TRADE ADJUSTMENT ASSISTANCE EXTENSION ACT OF 2011 (PUBLIC LAW 112–40) [115]

A. Health Coverage Improvements (secs. 241–243 of the Act and secs. 35, 4980B, 7527 and 9801 of the Code)

Present Law

In general

In the case of taxpayers who are eligible individuals,[116] a refundable tax credit is provided for 65 percent of the taxpayer's premiums for qualified health insurance of the taxpayer and qualifying family members [117] for each eligible coverage month beginning in the taxable year. The credit is commonly referred to as the health coverage tax credit ("HCTC"). The credit is available only with respect to amounts paid by the taxpayer for the qualified health insurance. The credit is available on an advance payment basis once a qualified health insurance costs credit eligibility certificate is in effect.[118]

The American Recovery and Reinvestment Act of 2009 and Omnibus Trade Act of 2010

The American Recovery and Reinvestment Act of 2009 [119] ("ARRA") made a number of temporary changes to the HCTC and related provisions that are generally effective for months beginning after February 17, 2009 and before January 1, 2011, or with respect to certain events occurring between those dates:

ARRA increased the amount of the HCTC to 80 percent of the taxpayer's premiums for qualified health insurance of the taxpayer and qualifying family members.

ARRA provided that the Secretary of the Treasury shall make one or more retroactive payments on behalf of certified individuals for qualified health insurance coverage of the taxpayer and qualifying family members.[120] For this purpose, a retroactive advance payment is an advance payment for eligible coverage months occur-

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[115] H.R. 2832. The House passed H.R. 2832 on September 7, 2011. The bill passed the Senate with an amendment on September 22, 2011. The House agreed to the Senate amendment on October 12, 2011. The President signed the bill on October 21, 2011.

[116] An eligible individual is an individual who is (1) an eligible Trade Adjustment Assistance ("TAA") recipient, (2) an eligible alternative TAA recipient, or (3) an eligible Pension Benefit Guaranty Corporation ("PBGC") pension recipient.

[117] Qualifying family members are the taxpayer's spouse and any dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency exemption. Any individual who has other specified coverage is not a qualifying family member.

[118] Sec. 7527.

[119] Pub. L. No. 111–5.

[120] This ARRA provision generally applies to months beginning after December 31, 2008 (rather than February 17, 2009) and before January 1, 2011.

ring prior to the first month for which an advance payment is otherwise made on behalf of such individual.

ARRA required that the qualified health insurance costs credit eligibility certificate provided in connection with the advance payment of the HCTC must include certain additional information.[121]

ARRA modified the definition of eligible individual by modifying the definition of an eligible Trade Adjustment Assistance ("TAA") recipient. Specifically, the ARRA eliminates the requirement that an individual be enrolled in training in the case of an individual receiving unemployment compensation.[122]

ARRA provided continued eligibility for the credit for family members after the following events: (1) the eligible individual becoming entitled to Medicare, (2) divorce, and (3) death.[123]

ARRA expanded the definition of qualified health insurance by including coverage under an employee benefit plan funded by a voluntary employees' beneficiary association[124] ("VEBA") established pursuant to an order of a bankruptcy court, or by agreement with an authorized representative, as provided in section 1114 of title 11, United States Code.

Under ARRA, in determining if there has been a 63-day lapse in coverage (which determines, in part, if State-based consumer protections apply), in the case of a TAA-eligible individual, the period beginning on the date the individual has a TAA-related loss of coverage and ending on the date which is seven days after the date of issuance by the Secretary (or by any person or entity designated by the Secretary) of a qualified health insurance costs credit eligibility certificate (under section 7527) for such individual is not taken into account.[125]

ARRA modified the maximum required COBRA continuation coverage period[126] with respect to certain individuals whose qualifying event is a termination of employment or a reduction in hours to coordinate with eligibility for HCTC as an eligible individual or a qualifying family member.[127]

The Omnibus Trade Act of 2010[128] extended the temporary changes to the HCTC and related provisions made by ARRA so

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[121] This ARRA provision applies for certificates issued after August 17, 2009 and months beginning before January 1, 2011.

[122] ARRA also clarifies that the definition of an eligible TAA recipient includes an individual who would be eligible to receive a trade readjustment allowance except that the individual is in a break in training that exceeds the period specified in section 233(e) of the Trade Act of 1974, but is within the period for receiving the allowance.

[123] This ARRA provision generally applies to months beginning after December 31, 2009 (rather than February 17, 2009) and before January 1, 2011.

[124] Sec. 501(c)(9).

[125] This ARRA provision applies to plan years beginning after February 17, 2009, and before January 1, 2011.

[126] The Consolidated Omnibus Reconciliation Act of 1985 ("COBRA") requires that a group health plan offer continuation coverage to qualified beneficiaries in the case of a qualifying event. An excise tax under the Code applies on the failure of a group health plan to meet the requirement. Sec. 4980B. Qualifying events include the death of the covered employee, termination of the covered employee's employment, divorce or legal separation of the covered employee, and certain bankruptcy proceedings of the employer. In the case of termination from employment, the coverage must be extended for a period of not less than 18 months. In certain other cases, coverage must be extended for a period of not less than 36 months. Under such period of continuation coverage, the plan may require payment of a premium by the beneficiary of up to 102 percent of the applicable premium for the period. Similar requirements apply under the Employee Retirement Income Security Act of 1974 and the Public Health Service Act.

[127] This ARRA provision is effective for periods of coverage that would, without regard to the provision, end on or after February 17, 1009, provided that the provision does not extend any periods of coverage beyond December 31, 2010.

[128] Pub. L. No. 111–344.

that the ARRA changes generally apply also to months beginning (or, for certain provisions, plan years beginning or events occurring) after December 31, 2010 and before February 13, 2011.[129]

Explanation of Provision

The Act extends the temporary changes to the HCTC and related provisions so that the changes generally apply also to months beginning (or, for certain provisions, plan years beginning or events occurring) after February 12, 2011 and before January 1, 2014.[130] For months beginning after February 12, 2011, and before January 1, 2014, the credit rate is 72.5 percent. The HCTC is terminated for months beginning after December 31, 2013.

Effective Date

The provision is generally effective for months beginning, plan years beginning, or events occurring after February 12, 2011.

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[129] The expansion of the definition of qualified health insurance to include coverage under an employee benefit plan funded by certain VEBAs is extended to apply to months beginning before February 13, 2012.

[130] Special transition rules apply with respect to the extension of certain provisions.

PART SIX: REVENUE PROVISIONS OF THE UNITED STATES-KOREA FREE TRADE AGREEMENT IMPLEMENTATION ACT (PUBLIC LAW 112–41) [131]

A. Increase in Penalty on Paid Preparers Who Fail To Comply With Earned Income Tax Credit Due Diligence Requirements (sec. 501 of the Act and sec. 6695(g) of the Code)

Present Law

Under Section 6695(g) of the Code, paid preparers who fail to comply with earned income tax credit due diligence requirements are fined $100 per return.

Reason for Change

Congress believes it is appropriate to increase the penalty for paid preparers who fail to comply with earned income tax credit due diligence requirements to deter non-compliance and for budgetary offset purposes.

Explanation of Provision

The Act increases the penalty for paid preparers who fail to comply with earned income tax credit due diligence requirements from $100 to $500 per return. The increased penalty applies to returns required to be filed after December 31, 2011.

Effective Date

The provision is effective for returns required to be filed after December 31, 2011.

B. Requirement For Prisons Located in the United States To Provide Information for Tax Administration (sec. 502 of the Act)

Present Law

No provision.

Reason for Change

The information provided will assist in detecting and deterring fraudulent tax return filings from inmates. Congress believes it is appropriate to identify inmates who are filing fraudulent tax returns and for budgetary offset purposes.

[131] H.R. 3080. The House Committee on Ways and Means reported H.R. 3080 on October 6, 2011 (H. Rep. No. 112–239). The House passed H.R. 3080 on October 12, 2011. The bill passed the Senate without amendment on October 12, 2011. The President signed the bill on October 21, 2011.

Explanation of Provision

The Act requires the head of the Federal Bureau of Prisons and the head of any State agency that administers prisons to provide certain information regarding inmates incarcerated, in electronic format, to the Secretary of the Treasury. The information must be filed no later than September 15, 2012, and annually thereafter.[132]

Effective Date

The provision is effective on the date of enactment (October 21, 2011).

C. Merchandise Processing Fee (sec. 503 of the Act)

Present Law

Section 8101 of the Omnibus Budget Reconciliation Act of 1986 ('OBRA') authorizes the Secretary of the Treasury to collect a merchandise processing fee for formal and informal entries in order to offset the salaries and expenses that will likely be incurred by the Customs Service in the processing of entries and releases. This authority has been consistently extended. Provided for under 19 U.S.C. 58c(a)(9)–(10), the merchandise processing fee is assessed on all goods entered or released from non-trade agreement partner countries. Presently, an ad valorem fee of 0.21 percent is mandated for merchandise that is entered formally. The fee is assessed on the value of the merchandise being imported, not including duty, freight, and insurance charges. The current minimum fee is $21, and the maximum fee is $485. Goods that are entered informally are charged a fee pursuant to a three-tiered flat rate fee table, depending on whether the fee is filed manually or electronically. The fee for informal entries ranges from $2.00 to $9.00 per shipment. The present fee level has been in place since 1995.

Reason for Change

Congress believes it is appropriate to increase the merchandise processing fees to address increased costs Customs and Border Protection has incurred as a result of the increased volume of trade and additional operational initiatives since the last legislative change to the merchandise processing fee in 1995.

Explanation of Provision [133]

The Act increases the ad valorem fee collected by Customs and Border Protection that offsets the costs incurred in processing and inspecting imports from 0.21 percent to 0.3464 percent. This is the first increase in this fee since 1995.

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[132] The information with respect to each inmate is: (1) first, middle, and last name, (2) date of birth, (3) institution of current incarceration or, for released inmates, most recent incarceration, (4) prison assigned inmate number, (5) the date of incarceration, (6) the date of release or anticipated date of release, (7) the date of work release, (8) taxpayer identification number and whether the prison has verified such number, (9) last known address, and (10) any additional information as the Secretary may request.

[133] All public laws enacted in the 112th Congress affecting this provision are described in Part Thirteen of this document.

Effective Date

The provision is effective on the date of enactment (October 21, 2011).

D. Customs User Fees (sec. 504 of the Act)

Present Law

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ('COBRA') authorizes the Secretary of the Treasury to collect passenger and conveyance processing fees and the merchandise processing fees. Section 412 of the Homeland Security Act of 2002 authorized the Secretary of the Treasury to delegate such authority to the Secretary of Homeland Security. COBRA has been amended on several occasions. The current authorization for the collection of the passenger and conveyance processing fees is through January 14, 2020. The current authorization for the collection of the Merchandise Processing Fee is through January 7, 2020.

Reason for Change

Congress believes it is appropriate to extend the passenger and conveyance processing fees authorized under COBRA for budgetary offset purposes.

Explanation of Provision [134]

The Act extends the passenger and conveyance processing fees and the merchandise processing fees authorized under Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ('COBRA') through December 8, 2020 and August 2, 2021, respectively.

Effective Date

The provision is effective on the date of enactment (October 21, 2011).

E. Time for Payment of Corporate Estimated Taxes (sec. 505 of the Act)

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

Reason for Change

Congress believes it is appropriate to adjust the corporate estimated tax payments for budgetary offset purposes.

[134] All public laws enacted in the 112th Congress affecting this provision are described in Part Thirteen of this document.

Explanation of Provision [135]

For corporations with assets of at least $1 billion, the Act increases the amount of the required installment of estimated tax otherwise due in July, August, or September of 2012 by 0.25 percent of such amount and increases the amount of the required installment of estimated tax otherwise due in July, August, or September of 2016 by 2.75 percent of such amount (determined without regard to any increase in such amount not contained in the Internal Revenue Code). The next required installment is reduced to reflect the prior increase.

Effective Date

The provision is effective on the date of enactment (October 21, 2011).

[135] All public laws enacted in the 112th Congress affecting this provision are described in Part Thirteen of this Explanation.

PART SEVEN: REPEAL OF THREE-PERCENT WITHHOLDING ON CERTAIN PAYMENTS MADE TO VENDORS, WORK OPPORTUNITY TAX CREDIT FOR VETERANS, OTHER PROVISIONS RELATED TO FEDERAL VENDORS AND MODIFICATION TO AGI CALCULATION FOR DETERMINING CERTAIN HEALTHCARE PROGRAM ELIGIBILITY (PUBLIC LAW 112–56) [136]

A. Repeal of Imposition of Three-Percent Withholding on Certain Payments Made to Vendors by Government Entities (sec. 102 of the Act and sec. 3402(t) of the Code)

Present Law

In general

Wages paid to employees, including wages and salaries of employees or elected officials of Federal, State, and local government units, are subject to withholding of income tax, which employers are required to collect and remit to the government. Withholding rates vary depending on the amount of wages paid, the length of the payroll period, and the number of withholding allowances claimed by the employee. The withholding amount is allowed as a credit against the individual taxpayer's income tax liability. It may be refunded if it is determined, when a tax return is filed, that the taxpayer's liability is less than the tax withheld, or additional tax may be due if it is determined that the taxpayer's liability is more than the tax withheld.

Certain nonwage payments also may be subject to withholding. Such payments include pensions,[137] gambling proceeds,[138] Social Security and other specified Federal payments,[139] unemployment compensation benefits,[140] and reportable payments such as dividends and interest.[141]

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[136] H.R. 674. The House Committee on Ways and Means reported H.R. 674 (H. Rep. 112–253) on October 18, 2011. The House passed H.R. 674 on October 27, 2011. The bill passed the Senate with an amendment on November 10, 2011. The House agreed to the Senate on November 16, 2011. The President signed the bill on November 21, 2011.

[137] Payors of pensions are required to withhold from payments made to payees, unless the payee elects no withholding. Withholding from periodic payments is at variable rates, parallel to income tax withholding from wages, whereas withholding from nonperiodic payments is at a flat 10-percent rate. Sec. 3405(a), (b). Withholding at a rate of 20 percent is required in the case of an eligible rollover distribution that is not directly rolled over. Sec. 3405(c).

[138] Certain gambling proceeds are subject to withholding obligations which vary depending on the form of wager or game. Sec. 3402(q)(3). Withholding is at a flat rate based on the third lowest rate of tax applicable to single taxpayers. Sec. 3402(q)(1). If the winnings are payable to a nonresident alien individual or a foreign corporation, the withholding regime generally applicable to foreigners applies instead of the withholding rules for gambling proceeds. Sec. 3402(q)(2).

[139] Voluntary withholding applies to specified Federal payments which include Social Security payments, certain payments received as a result of destruction or damage to crops, certain amounts received as loans from the Commodity Credit Corporation, and other payments.

[140] Withholding is voluntary and at a flat 10-percent rate. Sec. 3402(p)(2).

[141] A variety of payments (such as interest and dividends) are subject to backup withholding. For example, backup withholding is required if the payee has not provided a valid taxpayer

Nonbusiness income received by foreign persons from U.S. sources is generally subject to tax on a gross basis at a rate of 30 percent (14 percent for certain items of income), which is collected by withholding at the source of the payment.[142] The categories of income subject to the 30-percent tax and the categories for which withholding is required are generally coextensive, such that determination of the withholding tax liability determines the substantive liability.

Nonwage payments by governmental entities

Other than as described above, tax is not currently required to be withheld from payments made by government entities. Effective for payments made after December 31, 2011,[143] new withholding requirements apply to certain government payments for goods and services. Specifically, government entities must withhold three percent of any payments to persons providing property or services, unless an exception applies. Exceptions include: payments of interest; payments for real property; payments to tax-exempt entities or foreign governments; intra-governmental payments; payments made pursuant to a classified or confidential contract (as defined in section 6050M(e)(3)); and payments to government employees that are not otherwise excludable from this withholding provision with respect to the employees' services as employees. Government entities include the government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multistate agencies). The withholding requirement applies regardless of whether the government entity making such payment is the recipient of the property or services. Political subdivisions of States (or any instrumentality thereof) with less than $100 million of annual expenditures for property or services that would otherwise be subject to withholding under this provision are exempt from the withholding requirement.

Payments subject to three-percent withholding include any payment made in connection with a government voucher or certificate program which functions as a payment for property or services. For example, payments to a commodity producer under a government commodity support program are subject to the withholding requirement.

Withholding is not required with respect to government payments made through Federal, State, or local government public assistance or public welfare programs for which eligibility is determined by a needs or income test. For example, payments under government programs providing food vouchers or medical assistance to low-income individuals are not subject to withholding under the provision. However, payments under government programs to provide health care or other services that are not based on the needs or income of the recipients are subject to withholding, includ-

identification number ("TIN"). Withholding is at a flat rate based on the fourth lowest rate of tax applicable to single taxpayers. Sec. 3406.

[142] Secs. 1441 and 1442.

[143] Sec. 3402(t), which was added by section 511 of TIPRA. Pub. L. No. 109–222. As originally enacted, its provisions were to be effective for payments made after December 31, 2010. Section 1511 of ARRA delayed the effective date until payments made after December 31, 2011. Pub. L. No. 111–5. The regulations, as discussed infra, deferred the effective date an additional year.

ing programs where eligibility is based on the age of the beneficiary.

Three-percent withholding is not required with respect to payments of wages or any other payment with respect to which mandatory (e.g., U.S.-source income of foreign taxpayers) or voluntary (e.g., unemployment benefits) withholding applies under present law. In addition, if taxes are actually withheld from payments under the backup withholding rules, the three-percent withholding provision is not applicable.

Under final regulations issued by the Secretary of the Treasury, the withholding (and accompanying reporting) requirements apply to payments by government entities to any person providing property or services made after December 31, 2012.[144] Under these rules, a payment is subject to withholding if it is $10,000 or more on a payment-by-payment basis. Multiple payments by a government entity generally will not be aggregated in applying this $10,000 limit.

Reasons for Change

Congress understands that poor tax compliance by some government contractors has been identified as a contributing factor to the tax gap, or difference between the amount of tax owed by taxpayers and the amount voluntarily paid to the IRS. Congress recognizes that withholding and information reporting requirements can improve taxpayer compliance, but is concerned that the requirement of three-percent withholding on certain payments made to vendors by government entities is an overly broad remedy to this tax gap problem. Congress believes that this withholding requirement would reduce the cash flow to many cash-strapped employers that contract with governmental entities, undermining job creation. Congress further believes that the looming implementation of this requirement is contributing to the severe uncertainty facing employers during this challenging economic time. Moreover, Congress believes that the withholding requirement imposes substantial costs on Federal, State, and local governmental agencies required to withhold payments, including costs to acquire new software or pay for additional accounting services. In addition to direct costs of implementation, the possibility that three-percent withholding will result in increased procurement costs at all levels of government, as small businesses contracting with governmental entities adjust their prices to address the changes in their cash flows, also concerns Congress. Congress believes these burdens are disproportionate when compared to the resulting improvement in tax compliance and therefore believes that the three-percent withholding requirement should be repealed.

[144] Treas. Reg. sec. 31.3402(t)–1(d)(1). The final regulations provide an exception to the section 3402(t) withholding rules for payments made under a written binding contract (as defined) that was in effect on December 31, 2012, and is not materially modified. However, if an existing contract is materially modified (i.e., the contract is changed such that it materially affects either the payment terms of the contract or the services or property to be provided under the contract) after December 31, 2012, payments under the contract become subject to section 3402(t) withholding. Treas. Reg. sec. 31.3402(t)–1(d)(2).

Explanation of Provision

Under the proposal, section 3402(t) enacted under section 511 of TIPRA, is repealed.

Effective Date

The proposal is effective for payments made after December 31, 2011.

B. Returning Heroes and Wounded Warriors Work Opportunity Tax Credits (sec. 261 of the Act and secs. 51 and 52 of the Code)

Present Law

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages 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 (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

(1) Families receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (e.g., a State employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified veteran

Two subcategories of veterans qualify for the credit based on: (1) eligibility for food and nutrition assistance; and (2) compensation for a service-connected disability.

Food and nutrition assistance

A qualified veteran is a veteran who is certified by the designated local agency as a member of a family receiving assistance under a supplemental nutrition assistance program under the Food and Nutrition Act of 2008 for a period of at least three months part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a supplemental nutrition assistance program under the Food and Nutrition Act of 2008.

Entitled to compensation for a service-connected disability

A qualified veteran also includes an individual who is certified as entitled to compensation for a service-connected disability and: (1) having a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States; or (2) having been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring.

Definitions

For these purposes, being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S. Code, which means having a disability rating of 10 percent or higher for service connected injuries.

For these purposes, a veteran is 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 a qualified veteran 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.

(3) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law; and (2) having a hiring date within one year of release from prison or the date of conviction.

(4) Designated community residents

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community or a rural renewal community. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990–1994 and 1995–1999. Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community or a rural renewal community.

(5) Vocational rehabilitation referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (1) vocational rehabilitation services under an individualized, written plan for employment under a State plan approved under the Rehabilitation Act of 1973; (2) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code; or (3) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified summer youth employee

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15; (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date; (3) who has not been an employee of that employer before; and (4) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community. As with designated community residents, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues 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 will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified supplemental nutrition assistance program benefits recipient

A qualified supplemental nutrition assistance program benefits recipient is an individual at least age 18 but not yet age 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food and nutrition assistance program under the Food and Nutrition Act of 2008 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food and nutrition assistance under section 6(o) of the Food and Nutrition Act of 2008, the six-month requirement is replaced with a requirement that the family has been receiving food and nutrition assistance for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food and nutrition assistance program under the Food and Nutrition Act of 2008.

(8) Qualified SSI recipient

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income ("SSI") benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-term family assistance recipients

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit)[145] if the individual is hired within two years after the date that the 18-month total is reached; or (3) a member of a family who is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within two years after the Federal or State time limits made the family ineligible for family assistance.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) 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. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

[145] The welfare-to-work tax credit was consolidated into the work opportunity tax credit in the Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, for qualified individuals who begin to work for an employer after December 31, 2006.

In the case of a qualified veteran who is entitled to compensation for a service connected disability, the credit equals 40 percent of $12,000 of qualified first-year wages. This expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food and nutrition assistance program, as defined under present law.

Certification rules

An individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2011.

Explanation of Provision

In general

The provision modifies the work opportunity credit with respect to qualified veterans so that there are now five subcategories of qualified veterans: (1) in the case of veterans who were eligible to receive assistance under a supplemental nutritional assistance program (for at least a three month period during the year prior to the hiring date) the employer is entitled to a maximum credit of

40 percent of $6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of $12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service connected disability, and who has been unemployed for an aggregate of at least six months during the one year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of $24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $14,000 of qualified first-year wages.

Extension

The Act extends the credit for employers of qualified veterans through December 31, 2012, but does not extend the credit for other eligible categories.

Certification rules

Under the Act an otherwise qualified unemployed veteran is treated as certified by the designated local agency as having aggregate periods of unemployment (whichever is applicable under the qualified veterans rules described above) if such veteran is certified by such agency as being in receipt of unemployment compensation under a State or Federal law for such applicable periods.

The Secretary of the Treasury is authorized to provide alternative methods of certification for unemployed veterans.

Qualified tax-exempt organizations employing qualified veterans

If a qualified tax-exempt organization employs a qualified veteran (as described above) a tax credit against the FICA taxes of the organization is allowed on the wages of the qualified veteran which are paid for the veteran's services in furtherance of the activities related to the function or purpose constituting the basis of the organization's exemption under section 501.

The credit available to such tax-exempt employer for qualified wages paid to a qualified veteran equals 26 percent (16.25 percent for employment of 400 hours or less) of qualified first-year wages. The amount of qualified first-year wages eligible for the credit is the same as those for non-tax-exempt employers (i.e., $6,000, $12,000, $14,000 or $24,000, depending on the category of qualified veteran).

A qualified tax-exempt organization means an employer that is described in section 501(c) and exempt from tax under section 501(a).

Transfers to Federal Old-Age and Survivors Insurance Trust Fund

The Social Security Trust Funds are held harmless from the effects of this provision by a transfer from the Treasury General Fund.

Treatment of Possessions

The Act provides a reimbursement mechanism for the U.S. possessions (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the United States Virgin Islands). The Treasury Secretary is to pay to each mirror code possession (Guam, the Commonwealth of the Northern Mariana Islands, and the United States Virgin Islands) an amount equal to the loss to that possession as a result of the Act changes to the qualified veterans rules. Similarly, the Treasury Secretary is to pay to each non-mirror Code possession (American Samoa and the Commonwealth of Puerto Rico) the amount that the Secretary estimates as being equal to the loss to that possession that would have occurred as a result of the Act changes if a mirror code tax system had been in effect in that possession. The Secretary will make this payment to a non-mirror Code possession only if that possession establishes to the satisfaction of the Secretary that the possession has implemented (or, at the discretion of the Secretary, will implement) an income tax benefit that is substantially equivalent to the qualified veterans credit allowed under the Act modifications.

An employer that is allowed a credit against U.S. tax under the Act with respect to a qualified veteran must reduce the amount of the credit claimed by the amount of any credit (or, in the case of a non-mirror Code possession, another tax benefit) that the employer claims against its possession income tax.

Effective Date

The provision is effective for individuals who begin work for the employer after the date of enactment (November 21, 2011).

C. One Hundred-Percent Levy for Payments to Federal Vendors Relating to Property (sec. 301 of the Act and sec. 6331(h)(3) of the Code)

Present Law

In general

Levy is the IRS's administrative authority to seize a taxpayer's property, or rights to property, to pay the taxpayer's tax liability.[146] Generally, the IRS is entitled to seize a taxpayer's property by levy if a Federal tax lien has attached to such property,[147] and the IRS has provided both notice of intention to levy[148] and notice of the right to an administrative hearing (referred to as a "collec-

[146] Sec. 6331(a). Levy specifically refers to the legal process by which the IRS orders a third party to turn over property in its possession that belongs to the delinquent taxpayer named in a notice of levy.
[147] *Ibid.*
[148] Sec. 6331(d).

tions due process notice" or "CDP notice" and the hearing is referred to as the "CDP hearing")[149] at least 30 days before the levy is made. A Federal tax lien arises automatically when: (1) a tax assessment has been made; (2) the taxpayer has been given notice of the assessment stating the amount and demanding payment; and (3) the taxpayer has failed to pay the amount assessed within 10 days after the notice and demand.[150]

The notice of intent to levy is not required if the Secretary finds that collection would be jeopardized by delay. The standard for determining whether jeopardy exists is similar to the standard applicable when determining whether assessment of tax without following the normal deficiency procedures is permitted.[151]

The CDP notice (and pre-levy CDP hearing) is not required if: (1) the Secretary finds that collection would be jeopardized by delay; (2) the Secretary has served a levy on a State to collect a Federal tax liability from a State tax refund; (3) the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the beginning of the taxable period with respect to which the employment tax levy is served; or (4) the Secretary has served a Federal contractor levy. In each of these four cases, however, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy.[152]

Federal payment levy program

To help the IRS collect taxes more effectively, the Taxpayer Relief Act of 1997[153] authorized the establishment of the Federal Payment Levy Program ("FPLP"), which allows the IRS to continuously levy up to 15 percent of certain "specified payments," such as government payments to Federal contractors (including vendors) that are delinquent on their tax obligations. With respect to Federal payments to vendors of goods or services, the continuous levy may be up to 100 percent of each payment.[154] The term "goods or services" is not defined in the statute. The levy (either up to 15 percent or up to 100 percent) generally continues in effect until the liability is paid or the IRS releases the levy.

Under FPLP, the IRS matches its accounts receivable records with Federal payment records maintained by the Department of the Treasury's Financial Management Service ("FMS"), such as certain Social Security benefit and Federal wage records. When these records match, the delinquent taxpayer is provided both the notice of intention to levy and the CDP notice. If the taxpayer does not respond after 30 days, the IRS can instruct FMS to levy the taxpayer's Federal payments. Subsequent payments are continuously levied until such time that the tax debt is paid or IRS releases the levy.

[149] Sec. 6330. The notice and the hearing are referred to collectively as the CDP requirements.
[150] Sec. 6321.
[151] Secs. 6331(d)(3), 6861.
[152] Sec. 6330(f).
[153] Pub. L. No. 105–34.
[154] Sec. 6331(h)(3).

Explanation of Provision

The provision clarifies that Treasury can levy up to 100 percent of any payment due to a Federal vendor for the sale or lease of property, in addition to the sale or lease of goods or services.

Effective Date

The provision is effective for levies issued after the date of enactment (November 21, 2011).

D. Study and Report on Reducing the Amount of the Tax Gap Owed by Federal Contractors (sec. 302 of the Act)

Present Law

The term "tax gap" generally refers to the difference between the taxes that are rightfully owed to the Federal Government and the amount that is timely paid. Tax gap has been used over the years to refer to various aspects of noncompliance and efforts to measure that noncompliance. According to the IRS, "The tax gap is the difference between true tax liability for a given tax year and the amount that is paid on time. It is comprised of the nonfiling gap, the underreporting gap, and the underpayment gap." That definition can be said to be a definition of "gross tax gap." To the extent that the term is describing the portion of the taxes attributable to noncompliance and unlikely to be paid regardless of enforcement activity, the term is referring to "net tax gap."

Explanation of Provision

The provision requires the Secretary of the Treasury (or the Secretary's delegate) in consultation with the Director of the Office of Management and Budget and the heads of such other Federal agencies as the Secretary determines appropriate, to conduct a study of the gross tax gap that is attributable to Federal contractors. The study shall focus on ways to reduce the amount of Federal tax owed but not paid by persons submitting bids and proposals for the procurement of property or services by the Federal government.

The study shall include:

- An estimate of the amount of delinquent taxes owed by Federal contractors;
- The extent to which the requirement that persons submitting bids or proposals certify whether such persons have delinquent tax debts has improved tax compliance and been a factor in Federal agency decisions not to enter into or renew contracts with such contractors;
- In cases in which the Federal agencies continue to contract with persons who report having delinquent tax debt, the factors taken into consideration in awarding such contracts;
- The degree of success of the Federal lien and levy system in recouping delinquent taxes from Federal contractors;
- The number of persons who have been suspended or debarred because of a delinquent tax debt over the past three years;

- An estimate of the extent to which the subcontractors under Federal contracts have delinquent tax debt;
- The Federal agencies which have most frequently awarded contracts to persons notwithstanding any certification by such person that the person has delinquent tax debt;
- Recommendations on ways to better identify Federal contractors with delinquent tax debts.

Not later than 12 months after the date of enactment of this Act, the Secretary of the Treasury shall submit the study (along with any legislative recommendations) to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, the Committee on Oversight and Government Reform of the House of Representatives, and the Committee on Homeland Security and Government Affairs of the Senate.

Effective Date

The provision is effective on the date of its enactment (November 21, 2011).

E. Modification of Calculation of Modified Adjusted Gross Income for Determining Eligibility for Certain Healthcare-Related Programs (sec. 401 of the Act and sec. 36B of the Code)

Present Law

Premium assistance credit

For taxable years ending after December 31, 2013, a refundable tax credit (the "premium assistance credit") is provided for eligible individuals and families who purchase health insurance through an American Health Benefit Exchange. The premium assistance credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans through an American Health Benefit Exchange.

The premium assistance credit is available for individuals (single or joint filers) with household incomes between 100 and 400 percent of the Federal poverty level ("FPL") for the family size involved who are not eligible for certain other health insurance.[155] Household income is defined as the sum of: (1) the taxpayer's modified adjusted gross income, plus (2) the aggregate modified adjusted gross incomes of all other individuals taken into account in determining that taxpayer's family size (but only if such individuals are required to file a tax return for the taxable year). Modified adjusted gross income is defined as adjusted gross income increased by: (1) any amount excluded by section 911 (the exclusion from gross income for citizens or residents living abroad), plus (2) any tax-exempt interest received or accrued during the tax year.[156] To

[155] Individuals who are lawfully present in the United States but are not eligible for Medicaid because of their immigration status are treated as having a household income equal to 100 percent of FPL (and thus eligible for the premium assistance credit) as long as their household income does not actually exceed 100 percent of FPL.

[156] The definition of modified adjusted gross income used in section 36B is incorporated by reference for purposes of determining eligibility to participate in certain other healthcare-related programs, such as reduced cost-sharing (section 1402 of PPACA), Medicaid for the nonelderly (section 1902(e) of the Social Security Act (42 U.S.C. 1396a(e)) as modified by section 2002(a)

be eligible for the premium assistance credit, taxpayers who are married (within the meaning of section 7703) must file a joint return. Individuals who are listed as dependents on a return are ineligible for the premium assistance credit.

As described in Table 1 below, premium assistance credits are available on a sliding scale basis for individuals and families with household incomes between 100 and 400 percent of FPL to help subsidize the cost of private health insurance premiums. The premium assistance credit amount is determined based on the percentage of income the individual's or family's share of premiums represents, rising from two percent of income for those at 100 percent of FPL for the family size involved to 9.5 percent of income for those at 400 percent of FPL for the family size involved. After 2014, the percentages of income are indexed to the excess of premium growth over income growth for the preceding calendar year. After 2018, if the aggregate amount of premium assistance credits and cost-sharing reductions [157] exceeds 0.504 percent of the gross domestic product for that year, the percentage of income is also adjusted to reflect the excess (if any) of premium growth over the rate of growth in the consumer price index for the preceding calendar year. For purposes of calculating family size, individuals who are in the country illegally are not included.

TABLE 1—THE PREMIUM ASSISTANCE CREDIT PHASE-OUT

Household income (expressed as a percent of FPL)	Initial premium (percentage)	Final premium (percentage)
100% up to 133%	2.0	2.0
133% up to 150%	3.0	4.0
150% up to 200%	4.0	6.3
200% up to 250%	6.3	8.05
250% up to 300%	8.05	9.5
300% up to 400%	9.5	9.5

Minimum essential coverage and employer offer of health insurance coverage

Generally, if an employee is offered minimum essential coverage [158] in the group market, including employer-provided health insurance coverage, the individual is ineligible for the premium assistance credit for health insurance purchased through an American Health Benefit Exchange.

If an employee's share of the premium for self-only coverage exceeds 9.5 percent of an employee's household income or the plan's share of total allowed cost of provided benefits is less than 60 percent of such costs, the employee can be eligible for the premium assistance credit. Premium assistance tax credit eligibility requires that an employee decline enrollment in employer-offered coverage and satisfy the conditions for receiving a premium assistance tax credit through an American Health Benefit Exchange.

of PPACA) and the Children's Health Insurance Program (section 2102(b)(1)(B) of the Social Security Act (42 U.S.C. 1397bb(b)(1)(B)) as modified by section 2101(d) of PPACA).

[157] As described in section 1402 of PPACA.

[158] As defined in section 5000A(f).

Reconciliation

If the premium assistance credit received through advance payment exceeds the amount of premium assistance credit to which the taxpayer is entitled for the taxable year, the liability for the overpayment must be reflected on the taxpayer's income tax return for the taxable year subject to a limitation on the amount of such liability. For persons with household income below 400 percent of FPL, the liability for the overpayment for a taxable year is limited to a specific dollar amount (the "applicable dollar amount") as shown in Table 2 below (one-half of the applicable dollar amount shown in Table 2 for unmarried individuals who are not surviving spouses or filing as heads of households).[159]

TABLE 2—RECONCILIATION

Household income (expressed as a percent of FPL)	Applicable dollar amount
Less than 200%	$600
At least 200% but less than 300%	1,500
At least 300% but less than 400%	2,500

If the premium assistance credit for a taxable year received through advance payment is less than the amount of the credit to which the taxpayer is entitled for the year, the shortfall in the credit is also reflected on the taxpayer's tax return for the year.

Income taxation of Social Security benefits

Social Security benefits

Section 86 provides rules for determining what amount, if any, of a taxpayer's Social Security benefits are includible in gross income. Social Security benefits that are not taxed under section 86 are excluded from gross income. For purposes of section 86, Social Security benefits generally include monthly retirement benefits payable under title II of the Social Security Act and tier 1 Railroad Retirement benefits. If a taxpayer's Social Security benefits or Railroad Retirement benefits are offset by worker's compensation benefits, then the amount of the taxpayer's Social Security benefits is increased by the amount of such offset.

Portion of Social Security benefits includible in gross income

The amount of Social Security benefits includible in gross income is determined under a two-tier system. Taxpayers receiving Social Security benefits are not required to include any portion of such benefits in gross income if their provisional income does not exceed a first-tier threshold, which is $25,000, in the case of unmarried individuals, or $32,000, in the case of married individuals filing jointly.[160] For purposes of these computations, a taxpayer's provisional income is defined as adjusted gross income increased by certain amounts, including, generally: (1) tax-exempt interest; (2) exclud-

[159] Section 36B(f)(2)(i), as amended by section 4 of the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, Pub. L. No. 112–9 (April 14, 2011), discussed in Part Three, Section C.

[160] In the case of a married individual who files a separate return, the first-tier threshold is generally zero. However, if the individual lives apart from his or her spouse for the entire year, the first-tier threshold is $25,000.

able interest on educational savings bonds; (3) adoption assistance payments; (4) certain deductible student loan interest; (5) certain excludable foreign-source earned income; (6) certain U.S. possession income; and (7) one-half of the taxpayer's Social Security benefits. A second-tier threshold for provisional income is $34,000, in the case of unmarried individuals, or $44,000, in the case of married individuals filing joint returns.[161] These thresholds are not indexed for inflation.

If the taxpayer's provisional income exceeds the first-tier threshold but does not exceed the second-tier threshold, then the amount required to be included in gross income is the lesser of: (1) 50 percent of the taxpayer's Social Security benefits, or (2) 50 percent of the excess of the taxpayer's provisional income over the first-tier threshold.

If the amount of provisional income exceeds the second-tier threshold, then the amount required to be included in gross income is the lesser of: (1) 85 percent of the taxpayer's Social Security benefits; or (2) the sum of (a) 85 percent of the excess of the taxpayer's provisional income over the second-tier threshold, plus (b) the smaller of (i) the amount of benefits that would have been included in income if the 50-percent inclusion rule (described in the previous paragraph) were applied, or (ii) one-half of the difference between the taxpayer's second-tier threshold and first-tier threshold.[162] Tables 3 and 4 below summarize the income taxation of Social Security benefits.

TABLE 3—SUMMARY OF THE TAXATION OF SOCIAL SECURITY BENEFITS FOR UNMARRIED TAXPAYERS

<table>
<tr><th>Provisional income level</th><th colspan="3">Amount included in gross income</th></tr>
<tr><td>$24,999 and below</td><td colspan="3">0%</td></tr>
<tr><td>$25,000 to $33,999</td><td colspan="3">First-tier inclusion is the lesser of . . .</td></tr>
<tr><td></td><td>(1) 50% of Social Security benefit.</td><td colspan="2">(2) 50% of provisional income exceeding $25,000</td></tr>
<tr><td></td><td colspan="3">Second-tier inclusion is the lesser of . . .</td></tr>
<tr><td rowspan="2">$34,000 and above</td><td rowspan="2">(1) 85% of Social Security benefit.</td><td colspan="2">(2) 85% of the amount of provisional income exceeding $34,000 plus the lesser of . . .</td></tr>
<tr><td>(2a) $4,500</td><td>(2b) amount of Social Security benefit that would have been included if the 50% rule applied.</td></tr>
</table>

[161] In the case of a married individual who files a separate return, the second-tier threshold is generally zero. However, if the individual lives apart from his or her spouse for the entire year, the second-tier threshold is $34,000.

[162] Special rules apply in some cases. In the case of nonresident individuals who are not U.S. citizens, 85 percent of Social Security benefits are includible in gross income and subject to the 30-percent withholding tax (sec. 871(a)(3)). The taxation of Social Security benefits may also be specified in income tax treaties between the United States and other countries.

TABLE 4—SUMMARY OF THE TAXATION OF SOCIAL SECURITY BENEFITS FOR MARRIED TAXPAYERS

<table>
<tr><th>Provisional income level</th><th colspan="3">Amount included in gross income</th></tr>
<tr><td>$31,999 and below ....</td><td colspan="3">0%</td></tr>
<tr><td></td><td colspan="3">First-tier inclusion is the lesser of . . .</td></tr>
<tr><td>$32,000 to $43,999 ....</td><td>(1) 50% of Social Security benefit.</td><td colspan="2">(2) 50% of provisional income exceeding $32,000.</td></tr>
<tr><td></td><td colspan="3">Second-tier inclusion is the lesser of . . .</td></tr>
<tr><td rowspan="2">$44,000 and above ....</td><td rowspan="2">(1) 85% of Social Security benefit.</td><td colspan="2">(2) 85% of the amount of provisional income exceeding $44,000 plus the lesser of . . .</td></tr>
<tr><td>(2a) $6,000 ....</td><td>(2b) amount of Social Security benefit that would have been included if the 50% rule applied.</td></tr>
</table>

Reasons for Change

Congress believes that the full amount of a taxpayer's Social Security benefits should be taken into account in determining eligibility for the premium assistance credit and other benefits under Federally funded health programs, regardless of the portion of Social Security benefits includible in gross income. Taking the full amount of Social Security benefits into account for these purposes provides consistency with eligibility for other Federal needs-based programs and furthers the goal of deficit reduction.

Explanation of Provision

The provision revises the definition of modified adjusted gross income in section 36B to include the amount of the taxpayer's Social Security benefits that is excluded from gross income. Thus, for purposes of the premium assistance credit, modified adjusted gross income is defined as adjusted gross income increased by: (1) any amount excluded by section 911 (the exclusion from gross income for citizens or residents living abroad), (2) any tax-exempt interest received or accrued during the tax year, plus (3) an amount equal to the portion of the taxpayer's Social Security benefits excluded from gross income.[163]

Effective Date

The provision is effective on date of enactment. However, the premium assistance credit is not effective until taxable years end-

[163] Because the definition of modified adjusted gross income used in section 36B is incorporated by reference for purposes of determining eligibility to participate in certain other healthcare-related programs, such as reduced cost-sharing, Medicaid for the nonelderly, and the Children's Health Insurance Program, the revised definition applies also to those programs. In addition, the provision directs the Secretary of the Treasury (or the Secretary's delegate) to estimate annually the impact of the revised definition on the Social Security trust funds and, if a negative impact is estimated, to transfer an amount from the general fund sufficient to ensure that the Social Security trust funds are not reduced.

ing after December 31, 2013. Thus, the provision applies for taxable years ending after December 31, 2013.

PART EIGHT: THE REVENUE PROVISION CONTAINED IN THE TEMPORARY PAYROLL TAX CUT CONTINUATION ACT OF 2011 (PUBLIC LAW 112–78) [164]

A. Payroll Tax Cut (sec. 101 of the Act and sec. 601 of the Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010)

Present Law

Federal Insurance Contributions Act ("FICA") tax

The FICA tax applies to employers based on the amount of covered wages paid to an employee during the year.[165] Generally, covered wages means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash.[166] Certain exceptions from covered wages are also provided. The tax imposed is composed of two parts: (1) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base ($106,800 for 2011 and $110,100 for 2012); and (2) the Medicare hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages.

In addition to the tax on employers, each employee is generally subject to FICA taxes equal to the amount of tax imposed on the employer (the "employee portion").[167] The employee portion of FICA taxes generally must be withheld and remitted to the Federal government by the employer.

Self-Employment Contributions Act ("SECA") tax

As a parallel to FICA taxes, the SECA tax applies to the self-employment income of self-employed individuals.[168] The rate of the OASDI portion of SECA taxes is generally 12.4 percent, which is equal to the combined employee and employer OASDI FICA tax rates, and applies to self-employment income up to the FICA taxable wage base. Similarly, the rate of the HI portion of SECA tax is 2.9 percent, the same as the combined employer and employee HI rates under the FICA tax, and there is no cap on the amount of self-employment income to which the rate applies.[169]

An individual may deduct, in determining net earnings from self-employment under the SECA tax, the amount of the net earnings from self-employment (determined without regard to this deduc-

[164] H.R. 3765. The House passed H.R. 3765 on December 23, 2011. The bill passed the Senate without amendment on December 23, 2011. The President signed the bill on December 23, 2011.
[165] Sec. 3111.
[166] Sec. 3121(a).
[167] Sec. 3101. For taxable years beginning after 2012, an additional HI tax applies to certain employees.
[168] Sec. 1401.
[169] For taxable years beginning after 2012, an additional HI tax applies to certain self-employed individuals.

tion) for the taxable year multiplied by one half of the combined OASDI and HI rates.[170]

Additionally, a deduction, for purposes of computing the income tax of an individual, is allowed for one-half of the amount of the SECA tax imposed on the individual's self-employment income for the taxable year.[171]

Railroad retirement tax

Instead of FICA taxes, railroad employers and employees are subject, under the Railroad Retirement Tax Act ("RRTA"), to taxes equivalent to the OASDI and HI taxes under FICA.[172] The employee portion of RRTA taxes generally must be withheld and remitted to the Federal government by the employer.

Reduced OASDI rates for 2011

For 2011, the OASDI rate for the employee portion of the FICA tax, and the equivalent employee portion of the RRTA tax, is reduced by two percentage points to 4.2 percent. Similarly, for taxable years beginning in 2011, the OASDI rate for a self-employed individual is reduced by two percentage points to 10.4 percent.

Special rules coordinate the SECA tax rate reduction with a self-employed individual's deduction in determining net earnings from self-employment under the SECA tax and the income tax deduction for one-half of the SECA tax. The rate reduction is not taken into account in determining the SECA tax deduction allowed for determining the amount of the net earnings from self-employment for the taxable year. The income tax deduction allowed for SECA tax for taxable years beginning in 2011 is computed at the rate of 59.6 percent of the OASDI tax paid, plus one half of the HI tax paid.[173]

The Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974[174] receive transfers from the General Fund of the United States Treasury equal to any reduction in payroll taxes attributable to the rate reduction for 2011. The amounts are transferred from the General Fund at such times and in such a manner as to replicate to the extent possible the transfers which would have occurred to the Trust Funds or Benefit Account had the provision not been enacted.

For purposes of applying any provision of Federal law other than the provisions of the Code, the employee rate of OASDI tax is determined without regard to the reduced rate for 2011.

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[170] Sec. 1402(a)(12).

[171] Sec. 164(f).

[172] Secs. 3201(a) and 3211(a).

[173] This percentage replaces the rate of one half (50 percent) allowed under present law for this portion of the deduction. The new percentage is necessary to allow the self-employed individual to deduct the full amount of the employer portion of SECA taxes. The employer OASDI tax rate remains at 6.2 percent, while the employee portion falls to 4.2 percent. Thus, the employer share of total OASDI taxes is 6.2 divided by 10.4, or 59.6 percent of the OASDI portion of SECA taxes.

[174] 45 U.S.C. 231n–1(a).

Explanation of Provision [175]

Under the provision, the reduced employee OASDI tax rate of 4.2 percent under the FICA tax, and the equivalent employee portion of the RRTA tax, is extended to apply to covered wages paid in the first two months of 2012. The provision also provides for a recapture of any benefit a taxpayer may have received from the reduction in the OASDI tax rate, and the equivalent employee portion of the RRTA tax, for remuneration received during the first two months of 2012 in excess of $18,350.[176] The recapture is accomplished by a tax equal to two percent of the amount of wages (and railroad compensation) received during the first two months of 2012 that exceed $18,350. The provision directs the Secretary of the Treasury (or the Secretary's delegate) to prescribe regulations or other guidance that are necessary and appropriate to carry out this provision.

In addition, for taxable years beginning in 2012, the OASDI rate for a self-employed individual is reduced to 10.4 percent, for self-employment income of up to $18,350 (reduced by wages subject to the lower OASDI rate for 2012). Related rules for 2011 concerning coordination of a self-employed individual's deductions in determining net earnings from self-employment and income tax also apply for 2012, except that the income tax deduction allowed for the OASDI portion of SECA tax paid for taxable years beginning in 2012 is computed at the rate of 59.6 percent[177] of the OASDI tax paid on self-employment income of up to $18,350. For self-employment income in excess of this amount, the deduction is equal to half of the OASDI portion of the SECA tax paid.

Rules related to the OASDI rate reduction for 2011 concerning (1) transfers to the Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974, and (2) determining the employee rate of OASDI tax in applying provisions of Federal law other than the Code also apply for 2012.

Effective Date

The provision is effective for remuneration received during the months of January and February in 2012 and for self-employment income for taxable years beginning in 2012.

[175] See also Part Ten of this General Explanation for a description of a further extension of the payroll tax reduction.

[176] $18,350 is ⅙ of the 2012 taxable wage base of $110,100.

[177] This percentage used with respect to the first $18,350 of self-employment income is necessary to continue to allow the self-employed taxpayer to deduct the full amount of the employer portion of SECA taxes. The employer OASDI tax rate remains at 6.2 percent, while the employee portion falls to a 4.2 percent rate for the first $18,350 of self-employment income. Thus, the employer share of total OASDI taxes is 6.2 divided by 10.4, or 59.6 percent of the OASDI portion of SECA taxes, for the first $18,350 of self-employment income.

PART NINE: THE AIRPORT AND AIRWAY TRUST FUND PROVISIONS AND RELATED TAXES IN THE FAA MODERNIZATION AND REFORM ACT OF 2012 (PUBLIC LAW 112–95) [178]

A. Extension of Taxes Funding the Airport and Airway Trust Fund (sec. 1101 of the Act and secs. 4261, 4271, and 4081 of the Code)

Present Law

Overview

Excise taxes are imposed on amounts paid for commercial air passenger and freight transportation and on fuels used in commercial aviation and noncommercial aviation (i.e., transportation that is not "for hire") to fund the Airport and Airway Trust Fund. The present aviation excise taxes are as follows:

Tax (and Code section)	Tax Rates
Domestic air passengers (sec. 4261)	7.5 percent of fare, plus $3.80 (2012) per domestic flight segment generally [179]
International travel facilities tax (sec. 4261)	$16.70 (2012) per arrival or departure [180]
Amounts paid for right to award free or reduced rate passenger air transportation (sec. 4261).	7.5 percent of amount paid
Air cargo (freight) transportation (sec. 4271)	6.25 percent of amount charged for domestic transportation; no tax on international cargo transportation
Aviation fuels (sec. 4081): [181]	
1. Commercial aviation	4.3 cents per gallon
2. Non-commercial (general) aviation:	
Aviation gasoline	19.3 cents per gallon
Jet fuel	21.8 cents per gallon

All Airport and Airway Trust Fund excise taxes, except for 4.3 cents per gallon of the taxes on aviation fuels, are scheduled to expire after February 17, 2012. The 4.3-cents-per-gallon fuels tax rate is permanent.

Taxes on transportation of persons by air

Domestic air passenger excise tax

Domestic air passenger transportation generally is subject to a two-part excise tax. The first component is an *ad valorem* tax imposed at the rate of 7.5 percent of the amount paid for the trans-

[178] H.R. 658. The House passed H.R. 658 on April 1, 2011. The bill passed the Senate with an amendment on April 7, 2011. The conference report was filed on February 1, 2012 (H.R. Rep. No. 112–381) and was passed by the House on February 3, 2012, and the Senate on February 6, 2012. The President signed the bill on February 14, 2012.

[179] The domestic flight segment portion of the tax is adjusted annually (effective each January 1) for inflation (adjustments based on the changes in the consumer price index (the "CPI")).

[180] The international travel facilities tax rate is adjusted annually for inflation (measured by changes in the CPI).

[181] Like most other taxable motor fuels, aviation fuels are subject to an additional 0.1-cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund.

portation. The second component is a flight segment tax. For 2012, the flight segment tax rate is $3.80.[182] A flight segment is defined as transportation involving a single take-off and a single landing. For example, travel from New York to San Francisco, with an intermediate stop in Chicago, consists of two flight segments (without regard to whether the passenger changes aircraft in Chicago).

The flight segment component of the tax does not apply to segments to or from qualified “rural airports.” For any calendar year, a rural airport is defined as an airport that in the second preceding calendar year had fewer than 100,000 commercial passenger departures, and meets one of the following three additional requirements: (1) the airport is not located within 75 miles of another airport that had more than 100,000 such departures in that year; (2) the airport is receiving payments under the Federal “essential air service” program; or (3) the airport is not connected by paved roads to another airport.[183]

The domestic air passenger excise tax applies to “taxable transportation.” Taxable transportation means transportation by air that begins in the United States or in the portion of Canada or Mexico that is not more than 225 miles from the nearest point in the continental United States and ends in the United States or in such 225-mile zone. If the domestic transportation is paid for outside of the United States, it is taxable only if it begins and ends in the United States.

For purposes of the domestic air passenger excise tax, taxable transportation does not include “uninterrupted international air transportation.” Uninterrupted international air transportation is any transportation that does not both begin and end in the United States or within the 225-mile zone and does not have a layover time of more than 12 hours. The tax on international air passenger transportation is discussed below.

International travel facilities tax

For 2012, international air passenger transportation is subject to a tax of $16.70 per arrival or departure in lieu of the taxes imposed on domestic air passenger transportation if the transportation begins or ends in the United States.[184] The definition of international transportation includes certain purely domestic transportation that is associated with an international journey. Under these rules, a passenger traveling on separate domestic segments integral to international travel is exempt from the domestic passenger taxes on those segments if the stopover time at any point within the United States does not exceed 12 hours.

In the case of a domestic segment beginning or ending in Alaska or Hawaii, the tax applies to departures only and is $8.40 for calendar year 2012.

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[182] Sec. 4261(b)(1) and 4261(d)(4). The Code provides for a $3 tax indexed annually for inflation, effective each January 1, resulting in the current rate of $3.80.

[183] In the case of an airport qualifying as “rural” because it is not connected by paved roads to another airport, only departures for flight segments of 100 miles or more are considered in calculating whether the airport has fewer than 100,000 commercial passenger departures. The Department of Transportation has published a list of airports that meet the definition of rural airports. See Rev. Proc. 2005–45.

[184] Secs. 4261(c) and 4261(d)(4). The international air facilities tax rate of $12 is indexed annually for inflation, effective each January 1, resulting in the current rate of $16.70.

"Free" travel

Both the domestic air passenger tax and the use of international air facilities tax apply only to transportation for which an amount is paid. Thus, free travel, such as that awarded in "frequent flyer" programs and nonrevenue travel by airline industry employees, is not subject to tax. However, amounts paid to air carriers (in cash or in kind) for the right to award free or reduced-fare transportation are treated as amounts paid for taxable air transportation and are subject to the 7.5 percent ad valorem tax (but not the flight segment tax or the use of international air facilities tax). Examples of such payments are purchases of miles by credit card companies and affiliates (including airline affiliates) for use as "rewards" to cardholders.

Disclosure of air passenger transportation taxes on tickets and in advertising

Transportation providers are subject to special penalties relating to the disclosure of the amount of the passenger taxes on tickets and in advertising. The ticket is required to show the total amount paid for such transportation and the tax. The same requirements apply to advertisements. In addition, if the advertising separately states the amount to be paid for the transportation or the amount of taxes, the total shall be stated at least as prominently as the more prominently stated of the tax or the amount paid for transportation. Failure to satisfy these disclosure requirements is a misdemeanor, upon conviction of which the guilty party is fined not more than $100 per violation.[185]

Tax on transportation of property (cargo) by air

Amounts equivalent to the taxes received from the transportation of property by air are transferred to the Airport and Airway Trust Fund. Domestic air cargo transportation is subject to a 6.25 percent ad valorem excise tax on the amount paid for the transportation.[186] The tax applies only to transportation that both begins and ends in the United States. There is no disclosure requirement for the air cargo tax.

Aviation fuel taxes

The Code imposes excise taxes on gasoline used in commercial aviation (4.3 cents per gallon) and noncommercial aviation (19.3 cents per gallon), and on jet fuel (kerosene) and other aviation fuels used in commercial aviation (4.3 cents per gallon) and noncommercial aviation (21.8 cents per gallon).[187] Amounts equivalent to these taxes are transferred to the Airport and Airway Trust Fund.

[185] Sec. 7275.
[186] Sec. 4271.
[187] These fuels are also subject to an additional 0.1 cent per gallon for the Leaking Underground Storage Tank Trust Fund. If there was not a taxable sale of the fuel pursuant to section 4081 of the Code, a backup tax exists under section 4041(c) for such fuel that is subsequently sold or used in aviation.

Reasons for Change[188]

To ensure an uninterrupted funding source, Congress believes it is appropriate to extend further the taxes that finance the Airport and Airway Trust Fund.

Explanation of Provision

The Act extends the present-law Airport and Airway Trust Fund excise taxes through September 30, 2015.

Effective Date

The provision takes effect on February 18, 2012.

B. Extension of Airport and Airway Trust Fund Expenditure Authority (sec. 1102 of the Act, and sec. 9502 of the Code)

Present Law

In general

The Airport and Airway Trust Fund was created in 1970 to finance a major portion of Federal expenditures on national aviation programs. Operation of the Airport and Airway Trust Fund is governed by the Code and authorizing statutes. The Code provisions govern deposit of revenues into the trust fund and approve the use of trust fund money (as provided by appropriation acts) for expenditure purposes in authorizing statutes as in effect on the date of enactment of the latest authorizing Act. The authorizing acts provide specific trust fund expenditure programs and purposes.

Authorized expenditures from the Airport and Airway Trust Fund include the following principal programs:

1. Airport Improvement Program (airport planning, construction, noise compatibility programs, and safety projects);
2. Facilities and Equipment program (costs of acquiring, establishing, and improving the air traffic control facilities);
3. Research, Engineering, and Development program (Federal Aviation Administration ("FAA") research and development activities);
4. FAA Operations and Maintenance ("O&M") programs; and
5. Certain other aviation-related programs specified in authorizing acts.

Part of the O&M programs is financed from General Fund monies as well.[189]

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[188] See, S. Rep. No. 112–1 (February 14, 2011) at 3 (the committee report accompanying S. 340, the "Airport and Airway Trust Fund Reauthorization Act of 2011," as reported by the Senate Committee on Finance). See also, H. Rep. No. 112–44 (March 29, 2011) at 6 (the committee report accompanying H.R. 1034, the "Airport and Airway Trust Fund Financing Reauthorization Act of 2011" as reported by the House Committee on Ways and Means) ("Funding operations and improvements to the nation's airports and air infrastructure is vitally important to creating and sustaining economic growth and promoting commerce.").

[189] According to the Government Accountability Office, for FY 2000 through FY 2010 the contribution of general revenues has increased to cover a larger share of the FAA's operation expenditures. United States Government Accountability Office, *Airport and Airway Trust Fund: Declining Balance Raises Concerns Over Ability to Meet Future Demands, Statement of Gerald Dillingham, Director Physical Infrastructure Before the Committee on Finance, U.S. Senate* (GAO–11–358T), February 3, 2011, p. 5, Fig. 2. Congressional Budget Office, *Financing Federal Aviation Programs: Statement of Robert A. Sunshine before the House Committee on Ways and Means,* May 7, 2009, p. 3.

Limits on Airport and Airway Trust Fund expenditures

No expenditures are currently permitted to be made from the Airport and Airway Trust Fund after February 17, 2012. Because the purposes for which Airport and Airway Trust Fund monies are permitted to be expended are fixed as of the date of enactment of the Airport and Airway Extension Act of 2012, the Code must be amended to authorize new Airport and Airway Trust Fund expenditure purposes. In addition, the Code contains a specific enforcement provision to prevent expenditure of Airport and Airway Trust Fund monies for purposes not authorized under section 9502. Should such unapproved expenditures occur, no further aviation excise tax receipts will be transferred to the Airport and Airway Trust Fund. Rather, the aviation taxes would continue to be imposed, but the receipts would be retained in the General Fund.

Reasons for Change [190]

Congress believes that reauthorizing the Airport and Airway Trust Fund expenditure authority will support jobs throughout the aviation industry, such as financing airport construction projects across the country. Reauthorizing the FAA legislation and making investments to modernize the air traffic control system is estimated to create 280,000 jobs in airports throughout the country.

Explanation of Provision

The Act authorizes expenditures from the Airport and Airway Trust Fund through September 30, 2015. The Act also amends the list of authorizing statutes to include the "FAA Modernization and Reform Act of 2012," which sets forth aviation program expenditure purposes through September 30, 2015.

Effective Date

The provision takes effect on February 18, 2012.

C. Treatment of Fractional Ownership Aircraft Program Flights (sec. 1103 of the Act and new sec. 4043 of the Code)

Present Law

For excise tax purposes, fractional ownership aircraft flights are treated as commercial aviation. As commercial aviation, for 2012, such flights are subject to the *ad valorem* tax of 7.5 percent of the amount paid for the transportation, a $3.80 segment tax, and tax of 4.4 cents per gallon on fuel. For international flights, fractional ownership flights pay the $16.70 international travel facilities tax.

For purposes of the FAA safety regulations, fractional ownership aircraft programs are treated as a special category of general aviation.[191] Under those FAA regulations, a "fractional ownership program" is defined as any system of aircraft ownership and exchange that consists of all of the following elements: (i) the provision for fractional ownership program management services by a single fractional ownership program manager on behalf of the fractional

[190] See S. Rep. No. 112–1 (February 14, 2011) at 4.
[191] 14 C.F.R. Part 91, subpart k.

owners; (ii) two or more airworthy aircraft; (iii) one or more fractional owners per program aircraft, with at least one program aircraft having more than one owner; (iv) possession of at least a minimum fractional ownership interest in one or more program aircraft by each fractional owner; (v) a dry-lease aircraft exchange arrangement among all of the fractional owners; and (vi) multi-year program agreements covering the fractional ownership, fractional ownership program management services, and dry-lease aircraft exchange aspects of the program.

Reasons for Change [192]

Congress notes that the IRS and FAA classify flights on aircraft that are part of a fractional ownership program differently. Under the FAA safety regulations, such flights are considered general aviation, while the IRS classifies such flights as commercial aviation for tax purposes. Congress wishes to make clear that fractional flights should be considered as noncommercial aviation for tax purposes. In keeping with Congress' view that the burden of funding a modernized system should be broadly shared, Congress believes it is appropriate to subject such flights to the increased fuel taxes applicable to noncommercial aviation provided by the bill (35.9 cents per gallon), as well as an additional fuel surtax of 14.1 cents per gallon.

Explanation of Provision

The Act provides an exemption, through September 30, 2021, from the commercial aviation taxes (secs. 4261, 4271 and the 4.4 cents-per-gallon tax on fuel) for certain fractional aircraft program flights. In place of the commercial aviation taxes, the Act applies a fuel surtax to certain flights made as part of a fractional ownership program.

Through September 30, 2021, these flights are treated as noncommercial aviation, subject to the fuel surtax and the base fuel tax for fuel used in noncommercial aviation.[193] Specifically, the additional fuel surtax of 14.1 cents per gallon will apply to fuel used in a fractional program aircraft (1) for the transportation of a qualified fractional owner with respect to the fractional aircraft program of which such aircraft is a part, and (2) with respect to the use of such aircraft on the account of such a qualified owner. Such use includes positioning flights (flights in deadhead service).[194] Through September 30, 2021, the commercial aviation taxes do not apply to fractional program aircraft uses subject to the fuel surtax. Under the Act, flight demonstration, maintenance, and crew training flights by a fractional program aircraft are excluded from the fuel surtax and are subject to the noncommercial aviation

[192] See S. Rep. No. 112–1 (February 14, 2011) at 9.

[193] No inference is intended as to the treatment of these flights as noncommercial aviation under present law.

[194] A flight in deadhead service is presumed subject to the fuel surtax unless the costs for such flight are separately billed to a person other than a qualified owner. For example, if the costs associated with a positioning flight of a fractional program aircraft are separately billed to a person chartering the aircraft, that positioning flight is treated as commercial aviation.

fuel tax only.[195] The fuel surtax of 14.1 cents per gallon sunsets September 30, 2021.

A "fractional program aircraft" means, with respect to any fractional ownership aircraft program, any aircraft which is listed as a fractional program aircraft in the management specifications issued to the manager of such program by the Federal Aviation Administration under subpart K of part 91 of title 14, Code of Federal Regulations and is registered in the United States.

A "fractional ownership aircraft program" is a program under which:

- A single fractional ownership program manager provides fractional ownership program management services on behalf of the fractional owners;
- There are one or more fractional owners per program aircraft, with at least one program aircraft having more than one owner;
- With respect to at least two fractional program aircraft, none of the ownership interests in such aircraft can be less than the minimum fractional ownership interest, or held by the program manager;
- There exists a dry-lease aircraft exchange arrangement among all of the fractional owners; and
- There are multi-year program agreements covering the fractional ownership, fractional ownership program management services, and dry-lease aircraft exchange aspects of the program.

The term "qualified fractional owner" means any fractional owner that has a minimum fractional ownership interest in at least one fractional program aircraft. A "minimum fractional ownership interest" means: (1) A fractional ownership interest equal to or greater than one-sixteenth (1/16) of at least one subsonic, fixed wing or powered lift program aircraft; or (2) a fractional ownership interest equal to or greater than one-thirty-second (1/32) of at least one rotorcraft program aircraft. A "fractional ownership interest" is (1) the ownership interest in a program aircraft; (2) the holding of a multi-year leasehold interest in a program aircraft; or (3) the holding or a multi-year leasehold interest that is convertible into an ownership interest in a program aircraft. A "fractional owner" means a person owning any interest (including the entire interest) in a fractional program aircraft.

Amounts equivalent to the revenues from the fuel surtax are dedicated to the Airport and Airway Trust Fund.

Effective Date

The provision is effective for taxable transportation provided after, uses of aircraft after, and fuel used after, March 31, 2012.

[195] It is the understanding of the conferees that a prospective purchaser does not pay any amount for transportation by demonstration flights, and that if an amount were paid for the flight, the flight would be subject to the commercial aviation taxes and not treated as noncommercial aviation.

D. Transparency in Passenger Tax Disclosures (sec. 1104 of the Act and sec. 7275 of the Code)

Present Law

Transportation providers are subject to special penalties relating to the disclosure of the amount of the passenger taxes on tickets and in advertising. The ticket is required to show the total amount paid for such transportation and the tax. The same requirements apply to advertisements. In addition, if the advertising separately states the amount to be paid for the transportation or the amount of taxes, the total shall be stated at least as prominently as the more prominently stated of the tax or the amount paid for transportation. Failure to satisfy these disclosure requirements is a misdemeanor, upon conviction of which the guilty party is fined not more than $100 per violation.[196]

There is no prohibition against airlines including other charges in the required passenger taxes disclosure (e.g., fuel surcharges retained by the commercial airline). In practice, some but not all airlines include such other charges in the required passenger taxes disclosure.

Reasons for Change[197]

Congress believes that separating charges payable to a government entity from those paid to a transportation provider will reduce confusion on the part of consumers.

Explanation of Provision

The Act prohibits all transportation providers from including amounts other than the passenger taxes imposed by section 4261 in the required disclosure of passenger taxes on tickets and in advertising when the amount of such tax is separately stated. Disclosure elsewhere on tickets and in advertising (e.g., as an amount paid for transportation) of non-tax charges is allowed.

Effective Date

The provision is effective for transportation provided after March 31, 2012.

E. Tax-Exempt Private Activity Bond Financing for Fixed-Wing Emergency Medical Aircraft (sec. 1105 of the Act and sec. 147(e) of the Code)

Present Law

Interest on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes.[198] Bonds issued by State and local governments may be classified as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with

[196] Sec. 7275.
[197] See S. Rep. No. 112–1 (February 14, 2011) at 11.
[198] Sec. 103(a).

governmental funds. In general, private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals).[199] The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified bonds") and other Code requirements are met.[200]

Section 147(e) of the Code provides, in part, that a private activity bond is not a qualified bond if issued as part of an issue and any portion of the proceeds of such issue is used for airplanes.[201] The IRS has ruled that a helicopter is not an "airplane" for purposes of section 147(e).[202]

A fixed-wing aircraft providing air transportation for emergency medical services and that is equipped for, and exclusively dedicated on that flight to, acute care emergency medical services is exempt from the air transportation excise taxes imposed by sections 4261 and 4271.[203]

Reasons for Change[204]

Congress believes it is appropriate to correct the disparity by which tax-exempt bond financing may be used for helicopters providing emergency medical care but not for airplanes.

Explanation of Provision

The Act amends section 147(e) so that the prohibition on the use of proceeds for airplanes does not apply to any fixed-wing aircraft equipped for, and exclusively dedicated to, providing acute care emergency medical services (within the meaning of section 4261(g)(2)).

Effective Date

The provision is effective for obligations issued after the date of enactment (February 14, 2012).

F. Rollover of Amounts Received in Airline Carrier Bankruptcy (sec. 1106 of the Act and sec. 125 of the Worker, Retiree, and Employer Recovery Act of 2008)

Present Law

The Code provides for two types of individual retirement arrangements ("IRAs"): traditional IRAs and Roth IRAs.[205] In general, contributions (other than a rollover contribution) to a traditional IRA may be deductible from gross income, and distributions from a traditional IRA are includible in gross income to the extent

[199] See sec. 141 defining "private activity bond."
[200] See sec. 103(b) and sec. 141(e).
[201] Other prohibited facilities include any sky box, or other private luxury box, health club facility, facility primarily used for gambling, or store the principal business of which is the sale of alcoholic beverages for consumption off premises. Sec. 147(e).
[202] Rev. Rul. 2003–116, 2003–46 I.R.B. 1083, 2003–2 C.B. 1083, November 17, 2003 (released: October 29, 2003).
[203] Sec. 4261(g)(2).
[204] See S. Rep. No. 112–1 (Febraury 14, 2011) at 12.
[205] Traditional IRAs are described in section 408, and Roth IRAs are described in section 408A.

not attributable to a return of nondeductible contributions. In contrast, contributions to a Roth IRA are not deductible, and qualified distributions from a Roth IRA are excludable from gross income. Distributions from a Roth IRA that are not qualified distributions are includible in gross income to the extent attributable to earnings. In general, a qualified distribution is a distribution that (1) is made after the five taxable year period beginning with the first taxable year for which the individual first made a contribution to a Roth IRA, and (2) is made on or after the individual attains age 59½, death, or disability or which is a qualified special purpose distribution.

The total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount ($5,000 for 2012); or (2) the amount of the individual's compensation that is includible in gross income for the year.[206] In the case of married individuals filing a joint return, a contribution up to the dollar limit for each spouse may be made, provided the combined compensation of the spouses is at least equal to the contributed amount.

If an individual makes a contribution to an IRA (traditional or Roth) for a taxable year, the individual is permitted to recharacterize (in a trustee-to-trustee transfer) the amount of that contribution as a contribution to the other type of IRA (traditional or Roth) before the due date for the individual's income tax return for that year.[207] In the case of a recharacterization, the contribution will be treated as having been made to the transferee plan. The amount transferred must be accompanied by any net income allocable to the contribution and no deduction is allowed with respect to the contribution to the transferor plan. Both regular contributions and conversion contributions to a Roth IRA can be recharacterized as having been made to a traditional IRA. However, Treasury regulations limit the number of times a contribution for a taxable year may be recharacterized.[208]

Taxpayers generally may convert a traditional IRA into a Roth IRA.[209] The amount converted is includible in income as if a withdrawal had been made, except that the early distribution tax (discussed below) does not apply. However, the early distribution tax is applied if the taxpayer withdraws the amount within five years of the conversion.

If certain requirements are satisfied, a participant in an employer-sponsored qualified plan (which includes a qualified retirement plan described in section 401(a), a qualified retirement annuity described in section 403(a), a tax-sheltered annuity described in section 403(b), and a governmental eligible deferred compensation plan described in section 457(b)) or a traditional IRA may roll over distributions from the plan, annuity or IRA into another plan, annuity or IRA. For distributions after December 31, 2007, certain

[206] The maximum contribution amount is increased for individuals 50 years of age or older.
[207] Sec. 408A(d)(6).
[208] Treas. Reg. sec. 1.408A–5.
[209] For taxable years beginning prior to January 1, 2010, taxpayers with modified AGI in excess of $100,000, and married taxpayers filing separate returns, were generally not permitted to convert a traditional IRA into a Roth IRA. Under the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109–222, these limits on conversion are repealed for taxable years beginning after December 31, 2009.

taxpayers also are permitted to make rollover contributions into a Roth IRA (subject to inclusion in gross income of any amount that would be includible were it not part of the rollover contribution).

Under the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"),[210] a "qualified airline employee" may contribute any portion of an "airline payment amount" to a Roth IRA within 180 days of receipt of such amount (or, if later, within 180 days of enactment of the WRERA provision). Such a contribution is treated as a qualified rollover contribution to the Roth IRA. Thus, the portion of the airline payment amount contributed to the Roth IRA is includible in gross income to the extent that such payment would be includible were it not part of the rollover contribution.

A qualified airline employee is an employee or former employee of a commercial passenger airline carrier who was a participant in a defined benefit plan maintained by the carrier which: (1) is qualified under section 401(a); and (2) was terminated or became subject to the benefit accrual and other restrictions applicable to plans maintained by commercial passenger airlines pursuant to section 402(b) of the Pension Protection Act of 2006 ("PPA").

An airline payment amount is any payment of any money or other property payable by a commercial passenger airline to a qualified airline employee under the approval of an order of a Federal bankruptcy court in a case filed after September 11, 2001, and before January 1, 2007, and (2) in respect of the qualified airline employee's interest in a bankruptcy claim against the airline carrier, any note of the carrier (or amount paid in lieu of a note being issued), or any other fixed obligation of the carrier to pay a lump sum amount. An airline payment amount does not include any amount payable on the basis of the carrier's future earnings or profits. The amount that may be contributed to a Roth IRA is the gross amount of the payment; any reduction in the airline payment amount on account of withholding of the employee's share of taxes under the Federal Insurance Contributions Act ("FICA")[211] or income tax[212] is disregarded.

Explanation of Provision

The provision expands the choices for recipients of airline payment amounts by generally allowing qualified airline employees to contribute airline payment amounts to a traditional IRA as a rollover contribution within 180 days of receipt of such amount (or, if later, within 180 days of enactment of the provision). A qualified airline employee making such a rollover contribution may exclude the contributed airline payment amount from gross income in the taxable year in which the airline payment amount was paid to the qualified airline employee by the commercial passenger airline carrier.

A qualified airline employee who has made a qualified rollover contribution of an airline payment amount to a Roth IRA pursuant to WRERA is generally permitted to recharacterize all or a portion of the qualified rollover contribution as a rollover contribution to a

[210] Pub. L. No. 110–458, section 125.
[211] Sec. 3102.
[212] Sec. 3402.

traditional IRA by transferring, in a trustee-to-trustee transfer, the contribution (or a portion thereof) plus attributable earnings (or losses) from the Roth IRA. The airline payment amount so transferred (with attributable earnings) is deemed to have been contributed to the traditional IRA at the time of the initial rollover contribution into the Roth IRA if the trustee-to-trustee transfer to the traditional IRA is made within 180 days of the enactment of the provision. Airline payment amounts so transferred may be excluded from gross income in the taxable year in which the airline payment amount was paid to the qualified airline employee by the commercial passenger airline carrier. If an amount contributed to a Roth IRA as a rollover contribution is recharacterized as a rollover contribution to a traditional IRA, the amount so recharacterized may not be contributed to a Roth IRA as a qualified rollover contribution (i.e., reconverted to a Roth IRA) during the five taxable years immediately following the taxable year in which the transfer to the traditional IRA was made.

The ability to contribute airline payment amounts to a traditional IRA as a rollover contribution and the ability to recharacterize a previous qualified rollover contribution to a Roth IRA are subject to limitations. First, a qualified airline employee is not permitted to contribute (using either a rollover or recharacterization) an airline payment amount to a traditional IRA for a taxable year if, at any time during the taxable year or a preceding taxable year, the employee was a "covered employee," i.e., the principal executive officer (or an individual acting in such capacity) within the meaning of the Securities Exchange Act of 1934 or among the three most highly compensated officers for the taxable year (other than the principal executive officer), of the commercial passenger airline carrier making the airline payment amount.[213] Second, in the case of a qualified airline employee who was not at any time a covered employee, the amount that may be rolled over, or recharacterized, into a traditional IRA for a taxable year cannot exceed the excess (if any) of (1) 90 percent of the aggregate airline payment amounts received during the taxable year and all preceding taxable years, over (2) the aggregate amount rolled over, or recharacterized, into a traditional IRA for all preceding taxable years.

Subject to the limitations described above, qualified airline employees who were eligible to make a qualified rollover to a Roth IRA under WRERA, but declined to do so, are permitted under the provision to roll over the airline payment amount to a traditional IRA within 180 days of the receipt of the amount (or, if later, within 180 days of enactment of the provision), and such amount is excluded from income in the taxable year in which the airline pay-

[213] Covered employee status is defined by reference to section 162(m) (limiting deductions for compensation of covered employees), which defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year, and (2) the four most highly compensated officers for the taxable year (other than the chief executive officer), whose compensation is required to be reported to shareholders under the Securities Exchange Act of 1934. Treas. Reg. sec. 1.162–27(c)(2) provides that whether an employee is the chief executive officer or among the four most highly compensated officers is determined pursuant to the executive compensation disclosure rules promulgated under the Securities Exchange Act of 1934. To reflect 2006 changes made to the disclosure rules by the Securities and Exchange Commission, Notice 2007–49, 2007–25 I.R.B. 1429, provides that "covered employee" means any employee who is (1) the principal executive officer (or an individual acting in such capacity) within the meaning of the amended disclosure rules, or (2) among the three most highly compensated officers for the taxable year (other than the principal executive officer).

ment amount was paid by the commercial passenger airline carrier As mentioned above, any portion of an airline payment amount recharacterized as a rollover contribution to a traditional IRA pursuant to the provision is excluded from gross income in the taxable year in which the airline payment amount was paid by the commercial passenger airline carrier. A qualified airline employee who excludes from income an airline payment amount contributed to a traditional IRA (using either a rollover or recharacterization) may file a claim for a refund until the later of: (1) the usual period of limitation[214] (generally, three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later); or (2) April 15, 2013.

Surviving spouses of qualified airline employees are granted the same rights with respect to airline payment amounts as qualified airline employees both under the provision and under the WRERA provision.

An airline payment amount does not fail to be treated as a payment of wages for purposes of FICA taxes[215] and section 209 of the Social Security Act merely because the amount is excluded from gross income because it is contributed to a traditional IRA (using either a rollover or recharacterization) pursuant to the provision.

Effective Date

The provision is effective for all transfers (made after date of enactment of the provision) of airline payment amounts received before, on, or after date of enactment.

G. Termination of Exemption For Small Jet Aircraft on Nonestablished Lines (sec. 1107 of the Act and sec. 4281 of the Code)

Present Law

Under present law, transportation by aircraft with a certificated maximum takeoff weight of 6,000 pounds or less is exempt from the excise taxes imposed on the transportation of persons by air and the transportation of cargo by air when operating on a nonestablished line. Similarly, when such aircraft are operating on a flight for the sole purpose of sightseeing, the taxes imposed on the transportation or persons or cargo by air do not apply.

Reasons for Change[216]

The present-law tax exemption for small aircraft operating on nonestablished lines does not reflect the technological advances allowing for the construction of lightweight jet aircraft. Congress believes that such aircraft use FAA resources and utilize facilities receiving assistance from the Airport and Airway Trust Fund. Consistent with the intent of the Act that all aircraft making use of FAA resources bear an appropriate share of the cost, Congress finds that it is proper to remove jet aircraft from this exemption.

[214] Sec. 6511(a).
[215] Chapter 21 of the Code.
[216] See S. Rep. No. 112–1 (February 14, 2011) at 11.

Explanation of Provision

The Act repeals the exemption as it applies to turbine engine powered aircraft (jet aircraft).

Effective Date

The provision is effective for transportation provided after March 31, 2012.

H. Modification of Control Definition for Purposes of Section 249 (sec. 1108 of the Act and sec. 249 of the Code)

Present Law

In general, where a corporation repurchases its indebtedness for a price in excess of the adjusted issue price, the excess of the repurchase price over the adjusted issue price (the "repurchase premium") is deductible as interest.[217] However, in the case of indebtedness that is convertible into the stock of (1) the issuing corporation, (2) a corporation in control of the issuing corporation, or (3) a corporation controlled by the issuing corporation, section 249 provides that any repurchase premium is not deductible to the extent it exceeds "a normal call premium on bonds or other evidences of indebtedness which are not convertible."[218]

For purposes of section 249, the term "control" has the meaning assigned to such term by section 368(c). Section 368(c) defines "control" as "ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation." Thus, section 249 can apply to debt convertible into the stock of the issuer, the parent of the issuer, or a first-tier subsidiary of the issuer.

Explanation of Provision

The Act modifies the definition of "control" in section 249(b)(2) to incorporate indirect control relationships of the nature described in section 1563(a)(1). Section 1563(a)(1) defines a parent-subsidiary controlled group as one or more chains of corporations connected through stock ownership with a common parent corporation if (1) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d)(1)) by one or more of the other corporations; and (2) the common parent corporation owns (within the meaning of subsection (d)(1)) stock possessing at least 80 percent

[217] See Treas. Reg. sec. 1.163–7(c).

[218] Regulations under section 249 provide that "[f]or a convertible obligation repurchased on or after March 2, 1998, a call premium specified in dollars under the terms of the obligation is considered to be a normal call premium on a nonconvertible obligation if the call premium applicable when the obligation is repurchased does not exceed an amount equal to the interest (including original issue discount) that otherwise would be deductible for the taxable year of repurchase (determined as if the obligation were not repurchased)." Treas. Reg. sec. 1.249–1(d)(2). Where a repurchase premium exceeds a normal call premium, the repurchase premium is still deductible to the extent that it is attributable to the cost of borrowing (e.g., a change in prevailing yields or the issuer's creditworthiness) and not attributable to the conversion feature. See Treas. Reg. sec. 1.249–1(e).

of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

Effective Date

The provision is effective for repurchases after the date of enactment (February 14, 2012).

PART TEN: THE REVENUE PROVISIONS IN THE MIDDLE CLASS TAX RELIEF AND JOB CREATION ACT OF 2012 (PUBLIC LAW 112–96) [219]

A. Extension of Payroll Tax Reduction (sec. 1001 of the Act and sec. 601 of the Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010)

Present Law

Federal Insurance Contributions Act ("FICA") tax

The FICA tax applies to employers based on the amount of covered wages paid to an employee during the year.[220] Generally, covered wages means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash.[221] Certain exceptions from covered wages are also provided. The tax imposed is composed of two parts: (1) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base ($106,800 for 2011 and $110,100 for 2012); and (2) the Medicare hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages.

In addition to the tax on employers, each employee is generally subject to FICA taxes equal to the amount of tax imposed on the employer (the "employee portion").[222] The employee portion of FICA taxes generally must be withheld and remitted to the Federal government by the employer.

Self-Employment Contributions Act ("SECA") tax

As a parallel to FICA taxes, the SECA tax applies to the self-employment income of self-employed individuals.[223] The rate of the OASDI portion of SECA taxes is generally 12.4 percent, which is equal to the combined employee and employer OASDI FICA tax rates, and applies to self-employment income up to the FICA taxable wage base. Similarly, the rate of the HI portion of SECA tax is 2.9 percent, the same as the combined employer and employee HI rates under the FICA tax, and there is no cap on the amount of self-employment income to which the rate applies.[224]

An individual may deduct, in determining net earnings from self-employment under the SECA tax, the amount of the net earnings

[219] H.R. 3630. The House passed H.R. 3630 on December 13, 2011. The bill passed the Senate with an amendment on December 17, 2011. The conference report was filed on February 16, 2012 (H.R. Rep. No. 112–399) and was passed by the House on February 17, 2012, and the Senate on February 17, 2012. The President signed the bill on February 22, 2012.

[220] Sec. 3111.

[221] Sec. 3121(a).

[222] Sec. 3101. For taxable years beginning after 2012, an additional HI tax applies to certain employees.

[223] Sec. 1401.

[224] For taxable years beginning after 2012, an additional HI tax applies to certain self-employed individuals.

from self-employment (determined without regard to this deduction) for the taxable year multiplied by one half of the combined OASDI and HI rates.[225]

Additionally, a deduction, for purposes of computing the income tax of an individual, is allowed for one-half of the amount of the SECA tax imposed on the individual's self-employment income for the taxable year.[226]

Railroad retirement tax

Instead of FICA taxes, railroad employers and employees are subject, under the Railroad Retirement Tax Act ("RRTA"), to taxes equivalent to the OASDI and HI taxes under FICA.[227] The employee portion of RRTA taxes generally must be withheld and remitted to the Federal government by the employer.

Temporary reduced OASDI rates

Under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,[228] for 2011, the OASDI rate for the employee portion of the FICA tax, and the equivalent employee portion of the RRTA tax, is reduced by two percentage points to 4.2 percent. Similarly, for taxable years beginning in 2011, the OASDI rate for a self-employed individual is reduced by two percentage points to 10.4 percent.

Special rules coordinate the SECA tax rate reduction with a self-employed individual's deduction in determining net earnings from self-employment under the SECA tax and the income tax deduction for one-half of the SECA tax. The rate reduction is not taken into account in determining the SECA tax deduction allowed for determining the amount of the net earnings from self-employment for the taxable year. The income tax deduction allowed for the SECA tax for taxable years beginning in 2011 is 59.6 percent of the OASDI portion of the SECA tax imposed for the taxable year plus one-half of the HI portion of the SECA tax imposed for the taxable year.[229]

The Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974[230] receive transfers from the General Fund of the United States Treasury equal to any reduction in payroll taxes attributable to the rate reduction for 2011. The amounts are transferred from the General Fund at such times and in such a manner as to replicate to the extent possible the transfers which would have occurred to the Trust Funds or Benefit Account had the provision not been enacted.

[225] Sec. 1402(a)(12).
[226] Sec. 164(f).
[227] Secs. 3201(a) and 3211(a).
[228] Pub. L. No. 111–312.
[229] This percentage replaces the rate of one half (50 percent) otherwise allowed for this portion of the deduction. The percentage is necessary to allow the self-employed individual to deduct the full amount of the employer portion of SECA taxes. The employer OASDI tax rate remains at 6.2 percent, while the employee portion falls to 4.2 percent. Thus, the employer share of total OASDI taxes is 6.2 divided by 10.4, or 59.6 percent of the OASDI portion of SECA taxes.
[230] 45 U.S.C. 231n–1(a).

For purposes of applying any provision of Federal law other than the provisions of the Code, the employee rate of OASDI tax is determined without regard to the reduced rate for 2011.

Under the Temporary Payroll Tax Cut Continuation Act of 2011,[231] the reduced employee OASDI tax rate of 4.2 percent under the FICA tax, and the equivalent employee portion of the RRTA tax, is extended to apply to covered wages paid in the first two months of 2012. A recapture applies for any benefit a taxpayer may have received from the reduction in the OASDI tax rate, and the equivalent employee portion of the RRTA tax, for remuneration received during the first two months of 2012 in excess of $18,350.[232] The recapture is accomplished by a tax equal to two percent of the amount of wages (and railroad compensation) received during the first two months of 2012 that exceed $18,350. The Secretary of the Treasury (or the Secretary's delegate) is to prescribe regulations or other guidance that is necessary and appropriate to carry out this provision.

In addition, for taxable years beginning in 2012, the OASDI rate for a self-employed individual is reduced to 10.4 percent, for self-employment income of up to $18,350 (reduced by wages subject to the lower OASDI rate for 2012). Related rules for 2011 concerning coordination of a self-employed individual's deductions in determining net earnings from self-employment and income tax also apply for 2012, except that the income tax deduction allowed for the OASDI portion of SECA tax imposed for taxable years beginning in 2012 is computed at the rate of 59.6 percent[233] of the OASDI portion of the SECA tax imposed on self-employment income of up to $18,350. For self-employment income in excess of this amount, the deduction is equal to half of the OASDI portion of the SECA tax.

Rules related to the OASDI rate reduction for 2011 concerning (1) transfers to the Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974, and (2) determining the employee rate of OASDI tax in applying provisions of Federal law other than the Code also apply for 2012.

Explanation of Provision

Under the Act, the reduced employee OASDI tax rate of 4.2 percent under the FICA tax, and the equivalent portion of the RRTA tax, is extended to apply for 2012. Similarly, a reduced OASDI tax rate of 10.4 percent under the SECA tax, is extended to apply for taxable years beginning in 2012.

Related rules concerning (1) coordination of a self-employed individual's deductions in determining net earnings from self-employ-

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[231] Pub. L. No. 112–78, enacted after passage of H.R. 3630 by the House of Representatives and the Senate.

[232] $18,350 is 1/6 of the 2012 taxable wage base of $110,100.

[233] This percentage used with respect to the first $18,350 of self-employment income is necessary to continue to allow the self-employed taxpayer to deduct the full amount of the employer portion of SECA taxes. The employer OASDI tax rate remains at 6.2 percent, while the employee portion falls to a 4.2 percent rate for the first $18,350 of self-employment income. Thus, the employer share of total OASDI taxes is 6.2 divided by 10.4, or 59.6 percent of the OASDI portion of SECA taxes, for the first $18,350 of self-employment income.

ment and income tax, (2) transfers to the Federal Old-Age and Survivors Trust Fund, the Federal Disability Insurance Trust Fund and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974, and (3) determining the employee rate of OASDI tax in applying provisions of Federal law other than the Code also apply for 2012.

The Act repeals the present-law recapture provision applicable to a taxpayer who receives the reduced OASDI rate with respect to more than $18,350 of wages (or railroad compensation) received during the first two months of 2012, and removes the $18,350 limitation on self-employment income subject to the lower rate for taxable years beginning in 2012.

Effective Date

The provision applies to remuneration received, and taxable years beginning, after December 31, 2011.

B. Repeal of Certain Shifts in the Timing of Corporate Estimated Tax Payments (sec. 7001 of the Act)[234]

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability.[235] For a corporation whose taxable year is a calendar year, these estimated payments must be made by April 15, June 15, September 15, and December 15. In the case of a corporation with assets of at least $1 billion (determined as of the end of the preceding taxable year):

1. payments due in July, August or September, 2012, are increased to 100.5 percent of the payment otherwise due;[236]
2. payments due in July, August, or September, 2014, are increased to 174.25 percent of the payment otherwise due;[237]
3. payments due in July, August or September, 2015, are increased to 163.75 percent of the payment otherwise due;[238]
4. payments due in July, August, or September 2016 are increased to 103.5 percent of the payment otherwise due; and[239]

[234] See also part Thirteen B of this document.

[235] Sec. 6655.

[236] United States-Korea Free Trade Agreement Implementation Act, Pub. L. No. 112–41, sec 505, and United States-Panama Trade Promotion Agreement Implementation Act of 2011, Pub. L. No. 112–43, sec 502.

[237] Haiti Economic Lift Program of 2010, Pub. L. No. 111–171, sec. 12(a); Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111–152, sec. 1410; Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, sec. 561 (1); Act to extend the Generalized System of Preferences and the Andean Trade Preference Act, and for other purposes, Pub. L. No. 111–124, sec. 4; Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111–92, sec. 18; Joint resolution approving the renewal of import restrictions contained in the Burmese Freedom and Democracy Act of 2003, and for other purposes, Pub. L. No. 111–42, sec. 202(b)(1).

[238] Omnibus Trade Act of 2010, Pub. L. No. 111–344, sec. 10002; Small Business Jobs Act of 2010, Pub. L. No. 111–240, sec. 2131; Firearms Excise Tax Improvements Act of 2010, Pub. L. No. 111–237, sec. 4(a); United States Manufacturing Enhancement Act of 2010, Pub. L. No. 111–227, sec. 4002; Joint resolution approving the renewal of import restrictions contained in the Burmese Freedom and Democracy Act of 2003, and for other purposes, No. 111–210, sec. 3; Haiti Economic Lift Program of 2010, Pub. L. No. 111–171, sec. 12(b); Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, sec. 561(2).

[239] United States-Korea Free Trade Agreement Implementation Act, Pub. L. No. 112–41, sec 505; United States-Colombia Trade Promotion Agreement Implementation Act, Pub. L. No. 112–42, sec 603; and United States-Panama Trade Promotion Agreement Implementation Act, Pub. L. No. 112–43, sec 502.

5. payments due in July, August or September, 2019, are increased to 106.50 percent of the payment otherwise due.[240]

Explanation of Provision[241]

The Act reduces the applicable percentage for 2012 (100.5 percent), 2014 (174.25 percent), 2015 (163.75 percent), 2016 (103.5 percent), and 2019 (106.5 percent) to 100 percent. Thus corporations will be required to make estimated tax payments in 2012, 2014, 2015, 2016, and 2019 as if the prior legislation had never been enacted or amended.

Effective Date

The provision is effective on the date of enactment (February 22, 2012).

[240] Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, sec. 561(3).
[241] All public laws enacted in the 112th Congress affecting this provision are described in Part Thirteen of this document.

PART ELEVEN: REVENUE PROVISION OF THE NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2013 (PUBLIC LAW 112–239) [242]

A. Modification of Definition of Public Safety Officer (sec. 1086 of the Act and secs. 101(h) and 402(l) of the Code)

Present Law

Certain survivor annuities payable under a qualified retirement plan on account of the death of a public safety officer are excluded from income.[243] Certain distributions from a qualified retirement plan to a retired public safety officer are excluded from gross income (up to a limit of $3,000) if used to pay health insurance premiums.[244] For purposes of these exclusions, public safety officer is defined by reference to the definition in the Omnibus Crime Control and Safe Streets Act of 1968.[245]

Explanation of Provision

The National Defense Authorization Act for Fiscal Year 2013 ("NDA Act") amends the definition of public safety officer in the Omnibus Crime Control and Safe Streets Act of 1968. However, the NDA Act retains the prior-law definition of public safety officer for purposes of determining the exclusions from gross income under the Code.

Effective Date

The provision is effective when the amendment to the definition of public safety officer in the NDA Act takes effect.

[242] H.R. 4310. The House passed H.R. 4310 on May 18, 2012. The Senate passed the bill with an amendment on December 12, 2012. The conference report was filed on December 18, 2012 (H.R. Rep. No. 112–705) and was passed by the House on December 20, 2012, and by the Senate on December 21, 2012. The President signed the bill on January 2, 2013.
[243] Sec. 101(h).
[244] Sec. 402(l).
[245] 42 U.S.C. 3796b(9)(A).

PART TWELVE: REVENUE PROVISIONS CONTAINED IN THE AMERICAN TAXPAYER RELIEF ACT OF 2012 (PUBLIC LAW 112–240) [246]

TITLE I—GENERAL EXTENSIONS

A. Permanent Extension and Modification of 2001 Tax Relief (sec. 101 of the Act)

1. Individual income tax rate reductions (sec. 1 of the Code)

Present Law

In general

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases.

Prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") [247] the rate brackets were 15, 28, 31, 36, and 39.6 percent. EGTRRA created a new 10-percent regular income tax bracket for a portion of taxable income that was previously taxed at 15 percent. EGTRRA also reduced the tax rates in excess of 15 percent to 25, 28, 33, and 35 percent, respectively.

Tax rate schedules

Separate rate schedules apply based on an individual's filing status. The individual income tax rate schedules for 2012 are as follows:

TABLE 1—INDIVIDUAL INCOME TAX RATE SCHEDULES FOR 2012

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $8,700	10% of the taxable income
Over $8,700 but not over $35,350	$870 plus 15% of the excess over $8,700
Over $35,350 but not over $85,650	$4,867.50 plus 25% of the excess over $35,350
Over $85,650 but not over $178,650	$17,442.50 plus 28% of the excess over $85,650
Over $178,650 but not over $388,350	$43,482.50 plus 33% of the excess over $178,650
Over $388,350	$112,683.50 plus 35% of the excess over $388,350
Heads of Households	
Not over $12,400	10% of the taxable income
Over $12,400 but not over $47,350	$1,240 plus 15% of the excess over $12,400

[246] H.R. 8. The bill passed the House on August 1, 2012. The Senate passed the bill with an amendment on January 1, 2013. The House agreed to the Senate amendment on January 1, 2013. The President signed the bill on January 2, 2013. See also S. 3521, reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208), for a bill extending certain expiring provisions.

[247] Pub. L. No. 107–16. Any reference to a provision of EGTRRA is to the provision as amended by subsequent legislation which is subject to the EGTRRA sunset.

TABLE 1—INDIVIDUAL INCOME TAX RATE SCHEDULES FOR 2012—Continued

If taxable income is:	Then income tax equals:
Over $47,350 but not over $122,300	$6,482.50 plus 25% of the excess over $47,350
Over $122,300 but not over $198,050	$25,220 plus 28% of the excess over $122,300
Over $198,050 but not over $388,350	$46,430 plus 33% of the excess over $198,050
Over $388,350	$109,229 plus 35% of the excess over $388,350
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $17,400	10% of the taxable income
Over $17,400 but not over $70,700	$1,740 plus 15% of the excess over $17,400
Over $70,700 but not over $142,700	$9,735 plus 25% of the excess over $70,700
Over $142,700 but not over $217,450	$27,735 plus 28% of the excess over $142,700
Over $217,450 but not over $388,350	$48,665 plus 33% of the excess over $217,450
Over $388,350	$105,062 plus 35% of the excess over $388,350
Married Individuals Filing Separate Returns	
Not over $8,700	10% of the taxable income
Over $8,700 but not over $35,350	$870 plus 15% of the excess over $8,700
Over $35,350 but not over $71,350	$4,867.50 plus 25% of the excess over $35,350
Over $71,350 but not over $108,725	$13,867.50 plus 28% of the excess over $71,350
Over $108,725 but not over $194,175	$24,332.50 plus 33% of the excess over $108,725
Over $194,175	$52,531 plus 35% of the excess over $194,175

The following table is the staff of the Joint Committee on Taxation's calculation of the individual rate schedules for 2013 (assuming the expiration of the EGTRRA sunset).

TABLE 2—INDIVIDUAL INCOME TAX RATE SCHEDULES FOR 2013

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $36,250	15% of the taxable income
Over $36,250 but not over $87,850	$5,437.50 plus 28% of the excess over $36,250
Over $87,850 but not over $183,250	$19,886.50 plus 31% of the excess over $87,850
Over $183,250 but not over $398,350	$49,460.50 plus 36% of the excess over $183,250
Over $398,350	$126,896.50 plus 39.6% of the excess over $398,350
Heads of Households	
Not over $48,600	15% of the taxable income
Over $48,600 but not over $125,450	$7,290 plus 28% of the excess over $48,600
Over $125,450 but not over $203,150	$28,808 plus 31% of the excess over $125,450
Over $203,150 but not over $398,350	$52,895 plus 36% of the excess over $203,150
Over $398,350	$123,167 plus 39.6% of the excess over $398,350
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $60,550	15% of the taxable income
Over $60,550 but not over $146,400	$9,082.50 plus 28% of the excess over $60,550
Over $146,400 but not over $223,050	$33,120.50 plus 31% of the excess over $146,400
Over $223,050 but not over $398,350	$56,882 plus 36% of the excess over $223,050
Over $398,350	$119,990 plus 39.6% of the excess over $398,350
Married Individuals Filing Separate Returns	
Not over $30,275	15% of the taxable income
Over $30,275 but not over $73,200	$4,541.25 plus 28% of the excess over $30,275
Over $73,200 but not over $111,525	$16,560.25 plus 31% of the excess over $73,200
Over $111,525 but not over $199,175	$28,441 plus 36% of the excess over $111,525
Over $199,175	$59,995 plus 39.6% of the excess over $199,175

Explanation of Provision

The Act permanently extends the EGTRRA individual income tax rates for taxable incomes below the threshold amount. For taxable income above the threshold amount, the 39.6 percent rate which applied prior to the enactment of EGTRRA applies. The threshold amounts are (1) $450,000 in the case of a joint return or surviving spouse, (2) $425,000 in the case of a head of household, (3) $400,000 in the case of an unmarried person who is not a surviving spouse or head of household, and (4) $225,000 in the case of a married individual filing a separate return.[248] The threshold amounts are indexed for inflation. For 2013, the individual income tax rate schedules are as follows:

Table 3—Individual Income Tax Rate Schedules for 2013 [249]

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $8,925	10% of the taxable income
Over $8,925 but not over $36,250	$892.50 plus 15% of the excess over $8,925
Over $36,250 but not over $87,850	$4,991.25 plus 25% of the excess over $36,250
Over $87,850 but not over $183,250	$17,891.25 plus 28% of the excess over $87,850
Over $183,250 but not over $398,350	$44,603.25 plus 33% of the excess over $183,250
Over $398,350 but not over $400,000	$115,586.25 plus 35% of the excess over $398,350
Over $400,000	$116,163.75 plus 39.6% of the excess over $400,000
Heads of Households	
Not over $12,750	10% of the taxable income
Over $12,750 but not over $48,600	$1,275 plus 15% of the excess over $12,750
Over $48,600 but not over $125,450	$6,652.50 plus 25% of the excess over $48,600
Over $125,450 but not over $203,150	$25,865 plus 28% of the excess over $125,450
Over $203,150 but not over $398,350	$47,621 plus 33% of the excess over $203,150
Over $398,350 but not over $425,000	$112,037 plus 35% of the excess over $398,350
Over $425,000	$121,364.50 plus 39.6% of the excess over $425,000
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $17,850	10% of the taxable income
Over $17,850 but not over $72,500	$1,785 plus 15% of the excess over $17,850
Over $72,500 but not over $146,400	$9,982.50 plus 25% of the excess over $72,500
Over $146,400 but not over $223,050	$28,457.50 plus 28% of the excess over $146,400
Over $223,050 but not over $398,350	$49,919.50 plus 33% of the excess over $223,050
Over $398,350 but not over $450,000	$107,768.50 plus 35% of the excess over $398,350
Over $450,000	$125,846 plus 39.6% of the excess over $450,000
Married Individuals Filing Separate Returns	
Not over $8,925	10% of the taxable income
Over $8,925 but not over $36,250	$892.50 plus 15% of the excess over $8,925
Over $36,250 but not over $73,200	$4,991.25 plus 25% of the excess over $36,250
Over $73,200 but not over $111,525	$14,228.75 plus 28% of the excess over $73,200
Over $111,525 but not over $199,175	$24,959.75 plus 33% of the excess over $111,525
Over $199,175 but not over $225,000	$53,884.25 plus 35% of the excess over $199,175
Over $225,000	$62,923 plus 39.6% of the excess over $225,000

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

[248] For estates and trusts, the 39.6-percent rate applies to all taxable income in the highest rate bracket.

[249] A comparison of Table 3, below, with Table 2, above, illustrates the tax rate changes. Note that Table 3 also incorporates the provision to retain the marriage penalty relief with respect to the size of the 15-percent rate bracket, as discussed below.

2. Overall limitation on itemized deductions and the phase-out of personal exemptions (secs. 68 and 151 of the Code)

Present Law

Overall limitation on itemized deductions ("Pease" limitation)

An individual may elect to claim his or her itemized deductions for a taxable year in lieu of the standard deduction. Itemized deductions generally are those deductions which are not allowed in computing adjusted gross income ("AGI"). Itemized deductions include unreimbursed medical expenses, investment interest, casualty and theft losses, wagering losses, charitable contributions, qualified residence interest, State and local income taxes (or in lieu of income, sales taxes), property taxes, unreimbursed employee business expenses, and certain other miscellaneous expenses.

Prior to EGTRRA, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) was limited for upper-income taxpayers ("Pease" limitation). In computing this reduction of total itemized deductions, all limitations applicable to such deductions (such as the separate floors) were first applied and, then, the otherwise allowable total amount of itemized deductions was reduced by three percent of the amount by which the taxpayer's AGI exceeded a threshold amount, which was indexed annually for inflation. The otherwise allowable itemized deductions could not be reduced by more than 80 percent. EGTRRA phased-out and terminated the Pease limitation.

Pursuant to the EGTRRA sunset, the Pease limitation becomes fully effective again in 2013. Adjusting for inflation, the Joint Committee staff calculates the AGI threshold is $178,150 for 2013.

Personal exemption phase-out for certain taxpayers ("PEP")

Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2013, the amount deductible for each personal exemption is $3,900. This amount is indexed annually for inflation.

Prior to EGTRRA, the deduction for personal exemptions was reduced or eliminated for taxpayers with incomes over certain thresholds, which were indexed annually for inflation. Specifically, the total amount of exemptions that a taxpayer could claim was reduced by two percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeded the applicable threshold. The phase-out rate was two percent for each $1,250 for married taxpayers filing separate returns. Thus, a taxpayer's available personal exemptions were phased-out over a $122,500 range (which was not indexed for inflation), beginning at the applicable threshold. EGTRRA phased-out and terminated PEP.

Pursuant to the EGTRRA sunset, the personal exemption phase-out becomes fully effective again in 2013. The Joint Committee staff calculates the PEP thresholds for 2013 are: (1) $178,150 for single individuals; (2) $267,200 for married couples filing joint returns; and (3) $222,700 for heads of households.

Explanation of Provision

Overall limitation on itemized deductions ("Pease" limitation)

Under the Act, the "Pease" thresholds amounts are modified. The AGI thresholds for taxable years beginning in 2013 are (1) $250,000 for single individuals; (2) $300,000 for married couples filing joint returns and surviving spouses; (3) $275,000 for heads of households, and (4) $150,000 for a married individual filing a separate return. These amounts are indexed for inflation for taxable years beginning after 2013.

Personal exemption phase-out for certain taxpayers ("PEP")

Under the Act, the PEP threshold amounts are modified, and are the same as the AGI thresholds for the "Pease" limitation.

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

3. Increase the child tax credit (sec. 24 of the Code)

Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000 through 2012 and $500 thereafter.[250] A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.[251]

The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.[252]

The credit is allowable against the regular tax and, for taxable years beginning before January 1, 2013, is allowed against the alternative minimum tax ("AMT"). For taxable years beginning after December 31, 2012, the credit is not allowed against the AMT. To the extent the child credit exceeds the taxpayer's income tax liability, the taxpayer is eligible for a refundable credit[253] (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula).[254] The threshold dollar amount enacted by EGTRRA was $10,000 indexed for inflation. The American Recovery and Reinvestment Act

[250] Sec. 24(a).
[251] Sec. 24(c).
[252] Sec. 24(b).
[253] The refundable credit may not exceed the maximum credit per child of $1,000 through 2012 and $500 thereafter.
[254] Sec. 24(d).

of 2009 ("ARRA") reduced the threshold dollar amount to $3,000 (unindexed) for 2009 and 2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the $3,000 threshold for both 2011 and 2012. After 2012, the ability to determine the refundable child credit based on earned income in excess of the threshold dollar amount expires.

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income tax credit ("EITC"). After 2012, due to the expiration of the earned income formula, this is the only manner of obtaining a refundable child credit.

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. At the taxpayer's election, combat pay may be treated as earned income for these purposes. Unlike the EITC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EITC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Any credit or refund allowed or made to an individual under this provision (including to any resident of a U.S. possession) is not taken into account as income and shall not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

Explanation of Provision

The Act makes permanent the $1,000 child tax credit. The Act also permanently extends the repeal of a prior-law provision that reduced the refundable child credit by the amount of the AMT. Under the Act, the staff of the Joint Committee on Taxation calculates that in 2013, the earned income threshold for computing the refundable child credit is $13,400.[255] Finally, the Act permanently extends the rule that the refundable portion of the child tax credit does not constitute income and shall not be treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds.[256]

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[255] This amount is $10,000 indexed for inflation from 2001. See Title I, section C. 2. for additional discussion of the child credit.

[256] See Title I. section C. 4, below.

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

4. Marriage penalty relief and earned income tax credit simplification (secs. 1, 32 and 63 of the Code)

Present Law

Marriage penalty

A married couple generally is treated as one tax unit that must pay tax on the couple's total taxable income. Although married couples may elect to file separate returns, the rate schedules and other provisions are structured so that filing separate returns usually results in a higher tax than filing a joint return. Other rate schedules apply to single persons and to single heads of households.

A "marriage penalty" exists when the combined tax liability of a married couple filing a joint return is greater than the sum of the tax liabilities of each individual computed as if they were not married. A "marriage bonus" exists when the combined tax liability of a married couple filing a joint return is less than the sum of the tax liabilities of each individual computed as if they were not married.

Basic standard deduction

EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. The basic standard deduction for a married taxpayer filing separately continued to equal one-half of the basic standard deduction for a married couple filing jointly; thus, the basic standard deduction for unmarried individuals filing a single return and for married couples filing separately are the same. Under the sunset provisions of the EGTRRA, the provision will no longer apply for taxable years beginning after December 31, 2012.

15-percent rate bracket

EGTRRA increased the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return. Under the sunset provisions of the EGTRRA, the provision will no longer apply for taxable years beginning after December 31, 2012.

Earned income tax credit

The earned income tax credit ("EITC") is a refundable tax credit available to certain lower-income individuals. Generally, the amount of an individual's allowable earned income credit is dependent on the individual's earned income, adjusted gross income, and the number of qualifying children. Under the sunset provisions of the EGTRRA, the provision will no longer apply for taxable years beginning after December 31, 2012.

Explanation of Provision

Basic standard deduction

The Act permanently increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return permanently.

15-percent rate bracket

The Act permanently increases the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the 15-percent regular income tax rate bracket for an unmarried individual filing a single return permanently.

Earned income tax credit

The Act makes permanent the EITC provisions enacted by EGTRRA.

These include: (1) a simplified definition of earned income; (2) a simplified relationship test; (3) a simplified tie-breaking rule; (4) additional math error authority for the Internal Revenue Service; (5) a repeal of the prior-law provision that reduced an individual's EITC by the amount of his alternative minimum tax liability; and (6) a $3,000 increase in the beginning and ending points of the credit phase-out for married taxpayers.[257]

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

5. Education incentives (secs. 117, 127, 142, 146–148, 221, and 530 of the Code)

Present Law

Income and wage exclusion for awards under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program

Gross income does not include amounts received as a qualified scholarship by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution.[258] This exclusion does not extend to scholarship amounts covering regular living expenses, such as room and board. In addition to the exclusion for qualified scholarships, the Code provides an exclusion from gross income for qualified tuition reductions for certain education provided to employees (and their spouses and dependents) of certain educational organizations. Amounts excludable from gross income as amounts received as a

[257] The amount is indexed for inflation. See Title I, section C. 3. for additional discussion of the earned income tax credit.
[258] Sec. 117.

qualified scholarship are also excludable from wages for payroll tax purposes.[259]

The exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction. An exception to this rule applies in the case of the National Health Service Corps Scholarship Program (the "NHSC Scholarship Program") and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the "Armed Forces Scholarship Program").

The NHSC Scholarship Program and the Armed Forces Scholarship Program provide education awards to participants on the condition that the participants provide certain services. In the case of the NHSC Scholarship Program, the recipient of the scholarship is obligated to provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health care professionals. In the case of the Armed Forces Scholarship Program, the recipient of the scholarship is obligated to serve a certain number of years in the military at an armed forces medical facility.

Under the sunset provisions of the EGTRRA, the exclusion from gross income and wages for the NHSC Scholarship Program and the Armed Forces Scholarship Program will no longer apply for taxable years beginning after December 31, 2012.

Income and wage exclusion for employer-provided educational assistance

If certain requirements are satisfied, up to $5,250 annually of educational assistance provided by an employer to an employee is excludable from gross income for income tax purposes and from wages for employment tax purposes.[260] Under EGTRRA, this exclusion applies to both graduate and undergraduate courses. For the exclusion to apply, certain requirements must be satisfied. The educational assistance must be provided pursuant to a separate written plan of the employer. The employer's educational assistance program must not discriminate in favor of highly compensated employees. In addition, no more than five percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program can be provided for the class of individuals consisting of more than five-percent owners of the employer and the spouses or dependents of such more than five-percent owners.

For purposes of the exclusion, educational assistance means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees and similar payments, books, supplies, and equipment. Educational assistance also includes the provision by the employer of courses of instruction for the employee (including books, supplies, and equipment). Educational assistance does not include (1) tools or supplies that may be retained by the employee

[259] Sec. 3121(a)(20).
[260] Secs. 127, 3121(a)(18).

after completion of a course, (2) meals, lodging, or transportation, or (3) any education involving sports, games, or hobbies. The exclusion for employer-provided educational assistance applies only with respect to education provided to the employee (e.g., it does not apply to education provided to the spouse or a child of the employee).

In the absence of the specific exclusion for employer-provided educational assistance, employer-provided educational assistance is excludable from gross income and wages only if the education expenses qualify as a working condition fringe benefit.[261] In general, education qualifies as a working condition fringe benefit if the employee could have deducted the education expenses under section 162 if the employee paid for the education. In general, education expenses are deductible by an individual under section 162 if the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, applicable law, or regulations imposed as a condition of continued employment. However, education expenses are generally not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In determining the amount deductible for purposes of a working condition fringe benefit, the two-percent floor on miscellaneous itemized deductions is disregarded.

The specific exclusion will not be available for taxable years beginning after December 31, 2012. Thus, at that time, educational assistance will be excludable from gross income only if it qualifies as a working condition fringe benefit (i.e., the expenses would have been deductible as business expenses if paid by the employee). As previously discussed, to meet such requirement, the expenses must be related to the employee's current job.[262]

Deduction for student loan interest

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit.[263] Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending an eligible educational institution on at least a half-time basis. Eligible educational institutions are (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of high-

[261] Sec. 132(d).
[262] Treas. Reg. sec. 1.162–5.
[263] Sec. 221.

er education, a hospital, or a health care facility conducting post-graduate training. Additionally, to qualify as an eligible educational institution, an institution must be eligible to participate in Department of Education student aid programs.

The maximum allowable deduction per year is $2,500. For 2012, the deduction is phased out ratably for single taxpayers with AGI between $60,000 and $75,000 and between $125,000 and $155,000 for married taxpayers filing a joint return. The income phaseout ranges are indexed for inflation and rounded to the next lowest multiple of $5,000.

Effective for taxable years beginning after December 31, 2012, the changes made by EGTRRA to the student loan provisions no longer apply. The EGTRRA changes scheduled to expire are: (1) increases that were made in the AGI phaseout ranges for the deduction and (2) rules that extended deductibility of interest beyond the first 60 months that interest payments are required. With the expiration of the EGTRRA changes, the phaseout ranges will revert to a base level of $40,000 to $55,000 ($60,000 to $75,000 in the case of a married couple filing jointly), but with an adjustment for inflation occurring since 2002. Thus, the staff of the Joint Committee on Taxation estimates that the phaseout ranges will be $50,000 to $65,000 ($75,000 to $90,000 in the case of a married couple filing jointly) for 2013.

Coverdell education savings accounts

A Coverdell education savings account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary.[264] Annual contributions to Coverdell education savings accounts may not exceed $2,000 per designated beneficiary and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return); the AGI of the contributor, and not that of the beneficiary, controls whether a contribution is permitted by the taxpayer.

Earnings on contributions to a Coverdell education savings account generally are subject to tax when withdrawn.[265] However, distributions from a Coverdell education savings account are excludable from the gross income of the distributee (i.e., the student) to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. The earnings portion of a Coverdell education savings account distribution not used to pay qualified education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.[266]

Tax-free (including free of additional 10-percent tax) transfers or rollovers of account balances from one Coverdell education savings account benefiting one beneficiary to another Coverdell education

[264] Sec. 530.

[265] In addition, Coverdell education savings accounts are subject to the unrelated business income tax imposed by section 511.

[266] This 10-percent additional tax does not apply if a distribution from an education savings account is made on account of the death or disability of the designated beneficiary, or if made on account of a scholarship received by the designated beneficiary.

savings account benefiting another beneficiary (as well as redesignations of the named beneficiary) are permitted, provided that the new beneficiary is a member of the family of the prior beneficiary and is under age 30 (except in the case of a special needs beneficiary). In general, any balance remaining in a Coverdell education savings account is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if the beneficiary dies before attaining age 30, within 30 days of the date that the beneficiary dies).

Qualified education expenses include "qualified higher education expenses" and "qualified elementary and secondary education expenses."

The term "qualified higher education expenses" includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis.[267] Moreover, qualified higher education expenses include certain room and board expenses for any period during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified tuition program for the benefit of the beneficiary of the Coverdell education savings account.[268]

The term "qualified elementary and secondary education expenses," means expenses for: (1) tuition, fees, academic tutoring, special needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as determined under State law; (2) room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary; and (3) the purchase of any computer technology or equipment (as defined in section 170(e)(6)(F)(i)) or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary education expense unless the software is predominantly educational in nature.

Qualified education expenses generally include only out-of-pocket expenses. Such qualified education expenses do not include expenses covered by employer-provided educational assistance or scholarships for the benefit of the beneficiary that are excludable from gross income. Thus, total qualified education expenses are reduced by scholarship or fellowship grants excludable from gross income, as well as any other tax-free educational benefits, such as

[267] Qualified higher education expenses are defined in the same manner as for qualified tuition programs.
[268] Sec. 530(b)(2)(B).

employer-provided educational assistance, that are excludable from gross income.

Effective for taxable years beginning after December 31, 2012, the changes made by EGTRRA to Coverdell education savings accounts expire. The EGTRRA changes scheduled to expire are: (1) the increase in the contribution limit to $2,000 from $500; (2) the increase in the phaseout range for married taxpayers filing jointly to $190,000 to $220,000 from $150,000 to $160,000; (3) the expansion of qualified expenses to include elementary and secondary education expenses; (4) special age rules for special needs beneficiaries; (5) clarification that corporations and other entities are permitted to make contributions, regardless of the income of the corporation or entity during the year of the contribution; (6) certain rules regarding when contributions are deemed made and extending the time during which excess contributions may be returned without additional tax; (7) certain rules regarding coordination with the Hope and Lifetime Learning credits; and (8) certain rules regarding coordination with qualified tuition programs.

Amount of governmental bonds that may be issued by governments qualifying for the "small governmental unit" arbitrage rebate exception

To prevent State and local governments from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than needed for the purpose of the borrowing, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds.[269] The Code also provides certain exceptions to the arbitrage restrictions. Under one such exception, small issuers of governmental bonds issued for local governmental activities are not subject to the rebate requirement.[270] To qualify for this exception the governmental bonds must be issued by a governmental unit with general taxing powers that reasonably expects to issue no more than $5 million of tax-exempt governmental bonds in a calendar year.[271] Prior to EGTRRA, the $5 million limit was increased to $10 million if at least $5 million of the bonds are used to finance public schools. EGTRRA provided the additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirements is increased from $5 million to $10 million.[272] Thus, these governmental units may issue up to $15 million of governmental bonds in a calendar year provided that at least $10 million of the bonds are used to finance public school construction expenditures. This increase is subject to the EGTRRA sunset.

[269] The exclusion from gross income for interest on State and local bonds does not apply to any arbitrage bond (sec. 103(a), (b)(2)). A bond is an arbitrage bond if it is part of an issue that violates the restrictions against investing in higher-yielding investments under section 148(a) or that fails to satisfy the requirement to rebate arbitrage earnings under section 148(f).

[270] Ninety-five percent or more of the net proceeds of a governmental bond issue are to be used for local governmental activities of the issuer. Sec. 148(f)(4)(D).

[271] Under Treasury regulations, an issuer may apply a fact-based rather than an expectations-based test. Treas. Reg. sec. 1.148–8(c)(1).

[272] Sec. 148(f)(4)(D)(vii).

Issuance of tax-exempt private activity bonds for public school facilities

Interest on bonds that nominally are issued by State or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue act. These bonds are called "private activity bonds."[273] The term "private person" includes the Federal government and all other individuals and entities other than State or local governments.

Only specified private activity bonds are tax-exempt. EGTRRA added a new type of private activity bond that is subject to the EGTRRA sunset. This category is bonds for elementary and secondary public school facilities that are owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency.[274] The term school facility includes school buildings and functionally related and subordinate land (including stadiums or other athletic facilities primarily used for school events) and depreciable personal property used in the school facility. The school facilities for which these bonds are issued must be operated by a public educational agency as part of a system of public schools.

A public-private partnership agreement is defined as an arrangement pursuant to which the for-profit corporate party constructs, rehabilitates, refurbishes, or equips a school facility for a public school agency (typically pursuant to a lease arrangement). The agreement must provide that, at the end of the contract term, ownership of the bond-financed property is transferred to the public school agency party to the agreement for no additional consideration.

Issuance of these bonds is subject to a separate annual per-State private activity bond volume limit equal to $10 per resident ($5 million, if greater) in lieu of the present-law State private activity bond volume limits. As with the present-law State private activity bond volume limits, States can decide how to allocate the bond authority to State and local government agencies. Bond authority that is unused in the year in which it arises may be carried forward for up to three years for public school projects under rules similar to the carryforward rules of the present-law private activity bond volume limits.

Explanation of Provision

The Act makes permanent the EGTRRA changes to the NHSC Scholarship Program and the Armed Forces Scholarship Program, the section 127 exclusion from income and wages for employer-provided educational assistance, the student loan interest deduction, the Coverdell education savings accounts, the expansion of the small government unit exception to arbitrage rebate and the allow-

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[273] The Code provides that the exclusion from gross income does not apply to interest on private activity bonds that are not qualified bonds within the meaning of section 141. See secs. 103(b)(1), 141.

[274] Sec. 142(a)(13), (k).

ance of the issuance of tax-exempt private activity bonds for public school facilities. Thus, all of these tax benefits for education continue to be available after 2012.

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

6. Other incentives for families and children (includes extension of the adoption tax credit, employer-provided adoption assistance, employer-provided child care tax credit, and dependent care tax credit) (secs. 21, 23, 45D, and 137 of the Code)

Present Law

Adoption credit and exclusion from income for employer-provided adoption assistance

Present law for 2012 provides: (1) a nonrefundable adoption credit with a maximum of $12,650 per eligible child (both special needs and non-special needs adoptions); and (2) a maximum exclusion for employer-provided adoption assistance of $12,650 per eligible child (both special needs and non-special needs adoptions).[275] These dollar amounts are adjusted annually for inflation. These benefits are phased-out over a $40,000 range for taxpayers with modified adjusted gross income ("modified AGI") in excess of certain dollar levels. For 2012, the phase-out range is between $189,710 and $229,710. The phaseout threshold is adjusted for inflation annually, but the phaseout range remains a $40,000 range. Under present law, for purposes of the credit and exclusion, a special needs adoption finalized during the taxable year is deemed to include $12,650 of eligible expenses associated with that adoption, regardless of whether expenses rose to that level. Present law allows taxpayers to claim the adoption credit against their alternative minimum tax liability.

For taxable years beginning after December 31, 2012, the amount of the adoption credit is reduced to $6,000, and only applies in the case of special needs adoptions. The employer-provided adoption assistance exclusion terminates. The phase-out range is reduced to lower income levels (i.e., between $75,000 and $115,000). The maximum credit, exclusion, and phase-out range are not indexed for inflation. The provision providing for special rules regarding the expenses relating to special needs adoptions do

[275] Secs. 23 and 137. EGTRRA increased the maximum credit and exclusion to $10,000 (indexed for inflation after 2002) for both non-special needs and special needs adoptions, and increased the phase-out starting point to $150,000 (indexed for inflation after 2002). Section 10909 of the Patient Protection and Affordable Care Act (Pub. L. No. 111–148): (1) extended the EGTRRA expansion of the adoption credit and exclusion for employer-provided adoption assistance for one year (for 2011); (2) increased by $1,000 (to $13,170, indexed for inflation) the maximum adoption credit and exclusion from income for employer-provided adoption assistance for two years (2010 and 2011); and (3) made the credit refundable for two years (2010 and 2011). The 2010 Act extended for one year (2012) the EGTRRA expansion of the adoption credit and the exclusion from income for employer-provided adoption assistance. The changes to the adoption credit and exclusion from employer-provided adoption assistance for 2010 and 2011 (relating to the $1,000 increase in the maximum credit and exclusion and the refundability of the credit), enacted as part of the Patient Protection and Affordable Care Act, were not extended by the 2010 Act provision or otherwise.

not apply, and the credit may not offset alternative minimum tax liability.

Employer-provided child care tax credit

Taxpayers receive a tax credit equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. The maximum total credit that may be claimed by a taxpayer cannot exceed $150,000 per taxable year.

Qualified child care expenses include costs paid or incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of the taxpayer's qualified child care facility; (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care (unless it is the principal residence of the taxpayer), and the facility must meet all applicable State and local laws and regulations, including any licensing laws. A facility is not treated as a qualified child care facility with respect to a taxpayer unless: (1) it has open enrollment to the employees of the taxpayer; (2) use of the facility (or eligibility to use such facility) does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q)); and (3) at least 30 percent of the children enrolled in the center are dependents of the taxpayer's employees, if the facility is the principal trade or business of the taxpayer. Qualified child care resource and referral expenses are amounts paid or incurred under a contract to provide child care resource and referral services to the employees of the taxpayer. Qualified child care services and qualified child care resource and referral expenditures must be provided (or be eligible for use) in a way that does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q) of the Code.

Any amounts for which the taxpayer may otherwise claim a tax deduction are reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility is reduced by the amount of the credits.

Credits taken for the expenses of acquiring, constructing, rehabilitating, or expanding a qualified facility are subject to recapture for the first ten years after the qualified child care facility is placed in service. The amount of recapture is reduced as a percentage of the applicable credit over the 10-year recapture period. Recapture takes effect if the taxpayer either ceases operation of the qualified child care facility or transfers its interest in the qualified child care facility without securing an agreement to assume recapture liability for the transferee. The recapture tax is not treated as a tax for purposes of determining the amount of other credits or determining the amount of the alternative minimum tax. Other rules apply.

The tax credit expires for taxable years beginning after December 31, 2012.

Dependent care tax credit

The maximum dependent care tax credit is $1,050 (35 percent of up to $3,000 of eligible expenses) if there is one qualifying individual, and $2,100 (35 percent of up to $6,000 of eligible expenses) if there are two or more qualifying individuals.[276] The 35-percent credit rate is reduced, but not below 20 percent, by one percentage point for each $2,000 (or fraction thereof) of adjusted gross income above ("AGI") $15,000. Therefore, the credit percentage is reduced to 20 percent for taxpayers with AGI over $43,000. Generally, eligible expenses include expenses for household services and expenses for the care of a qualifying individual but only if such expenses are incurred to enable the taxpayer to be gainfully employed.

The level of this credit is reduced for taxable years beginning after December 31, 2012, under EGTRRA.

Explanation of Provision

Adoption credit and exclusion from income for employer-provided adoption assistance

The Act makes permanent the EGTRRA expansion of these two provisions. Therefore, for 2013, the maximum benefit is $12,170 (indexed for inflation after 2010). The adoption credit and exclusion are phased out ratably for taxpayers with modified adjusted gross income between $193,930 and $233,930 (indexed for inflation) for 2013.[277] The 2012 rules relating to expenses for special needs adoptions are retained, and taxpayers remain able to offset their alternative minimum tax liability with the credit.

Employer-provided child care tax credit

The Act makes permanent the EGTRRA expansion of the employer-provided child tax credit.

Expansion of dependent care tax credit

The Act makes permanent the EGTRRA expansion of the dependent care tax credit.

Effective Date

The provisions apply to taxable years beginning after December 31, 2012.

7. Alaska native settlement trusts (sec. 646 of the Code)

Present Law

The Alaska Native Claims Settlement Act ("ANCSA")[278] established Alaska Native Corporations to hold property for Alaska Natives. Alaska Natives are generally the only permitted common shareholders of those corporations under section 7(h) of ANCSA, which provides restrictions regarding the transfer of Settlement

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[276] Sec. 21.

[277] The changes to the adoption credit and exclusion from employer-provided adoption assistance for 2010 and 2011 (relating to the $1,000 increase in the maximum credit and exclusion and the refundability of the credit) enacted as part of the Patient Protection and Affordable Care Act, are not extended by the provision.

[278] 43 U.S.C. 1601 *et. seq.*

Common Stock, unless an Alaska Native Corporation specifically allows other shareholders under specified procedures.

ANCSA permits an Alaska Native Corporation to transfer money or other property to an Alaska Native Settlement Trust ("Settlement Trust") for the benefit of beneficiaries who constitute all or a class of the shareholders of the Alaska Native Corporation, to promote the health, education and welfare of beneficiaries and to preserve the heritage and culture of Alaska Natives.[279]

Alaska Native Corporations and Settlement Trusts, as well as their shareholders and beneficiaries, are generally subject to tax under the same rules and in the same manner as other taxpayers that are corporations, trusts, shareholders, or beneficiaries.

Special tax rules allow an election to use a more favorable tax regime for transfers of property by an Alaska Native Corporation to a Settlement Trust and for income taxation of the Settlement Trust.[280] There is also simplified reporting to beneficiaries.[281]

Under the special tax rules, a Settlement Trust may make an irrevocable election to pay tax on taxable income at the lowest rate specified for individuals (rather than the highest rate that is generally applicable to trusts) and to pay tax on capital gains at a rate consistent with being subject to such lowest rate of tax. As described further below, beneficiaries may generally thereafter exclude from gross income distributions from a trust that has made this election. Also, contributions from an Alaska Native Corporation to an electing Settlement Trust generally will not result in the recognition of gross income by beneficiaries on account of the contribution. An electing Settlement Trust remains subject to generally applicable requirements for classification and taxation as a trust.

A Settlement Trust distribution is excludable from the gross income of beneficiaries to the extent of the taxable income of the Settlement Trust for the taxable year and all prior taxable years for which an election was in effect, decreased by income tax paid by the Trust, plus tax-exempt interest from State and local bonds for the same period. Amounts distributed in excess of the amount excludable is taxed to the beneficiaries as if distributed by the sponsoring Alaska Native Corporation in the year of distribution by the Trust, which means that the beneficiaries must include in gross income as dividends the amount of the distribution, up to the current and accumulated earnings and profits of the Alaska Native Corporation. Amounts distributed in excess of the current and accumulated earnings and profits are not included in gross income by the beneficiaries.

A special loss disallowance rule reduces (but not below zero) any loss that would otherwise be recognized upon disposition of stock of a sponsoring Alaska Native Corporation by a proportion, determined on a per share basis, of all contributions to all electing Settlement Trusts by the sponsoring Alaska Native Corporation. This rule prevents a stockholder from being able to take advantage of

[279] With certain exceptions, once an Alaska Native Corporation has made a conveyance to a Settlement Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgment, except with respect to the lawful debts and obligations of the Settlement Trust.

[280] Sec. 646.

[281] Sec. 6039H.

a decrease in value of an Alaska Native Corporation that is caused by a transfer of assets from the Alaska Native Corporation to a Settlement Trust.

The fiduciary of an electing Settlement Trust is obligated to provide certain information relating to distributions from the trust in lieu of reporting requirements under Section 6034A.

The earnings and profits of an Alaska Native Corporation are not reduced by the amount of its contributions to an electing Trust at the time of the contributions. However, the Alaska Native Corporation earnings and profits are reduced as and when distributions to the beneficiaries are thereafter made by the electing Trust that are taxed to the beneficiaries as dividends from the Alaska Native Corporation.

The election to pay tax at the lowest rate is not available in certain disqualifying cases: (a) where transfer restrictions have been modified either to allow a transfer of a beneficial interest that would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act if the interest were Settlement Common Stock, or (b) where transfer restrictions have been modified to allow a transfer of any Stock in an Alaska Native Corporation that would not be permitted by section 7(h) if it were Settlement Common Stock and the Alaska Native Corporation thereafter makes a transfer to the Trust. Where an election is already in effect at the time of such disqualifying situations, the special rules applicable to an electing trust cease to apply and rules generally applicable to trusts apply. In addition, the distributable net income of the trust is increased by undistributed current and accumulated earnings and profits of the trust, limited by the fair market value of trust assets at the date the trust becomes so disposable. The effect is to cause the trust to be taxed at regular trust rates on the amount of recomputed distributable net income not distributed to beneficiaries, and to cause the beneficiaries to be taxed on the amount of any distributions received consistent with the applicable tax rate bracket.

The special rules do not apply to taxable years beginning after December 31, 2012.

Explanation of Provision

The Act makes permanent the EGTRRA amendments relating to electing Settlement Trusts.

Effective Date

The provision applies to taxable years of electing Settlement Trusts, their beneficiaries, and sponsoring Alaska Native Corporations beginning after December 31, 2012.

8. Estate, gift, and generation-skipping transfer taxes (secs. 2001 and 2010 of the Code)

Present Law

In general

In general, a gift tax is imposed on certain lifetime transfers and an estate tax is imposed on certain transfers at death. A generation skipping transfer tax generally is imposed on certain transfers, made either directly or in trust or using a similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation younger than that of the transferor). Transfers subject to the generation skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

A unified credit is available with respect to taxable transfers by gift and at death.[282] The unified credit offsets tax computed at the lowest estate and gift tax rates on a specified amount of transfers, referred to as the applicable exclusion amount. The applicable exclusion amount for estate and gift tax is $5 million (indexed for inflation for years after 2011). For 2012, the inflation-indexed estate and gift tax applicable exclusion amount is $5.12 million. The generation skipping transfer tax exclusion is equal to the applicable exclusion amount for estate tax purposes. The top estate and gift tax rate is 35 percent.

A deduction is allowed for certain death taxes paid to any State or the District of Columbia.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("2010 Extension Act")[283] extended certain special temporary rules originally enacted as part of EGTRRA relating to: (1) allocation of generation skipping transfer tax exemption; (2) estate tax conservation easements; and (3) installment payments of estate taxes.[284]

Portability of unused exclusion between spouses

Under a temporary provision enacted as part of the 2010 Extension Act, any applicable exclusion amount that remains unused as of the death of a spouse who dies after December 31, 2010 (the deceased spousal unused exclusion amount), generally is available for use by the surviving spouse, as an addition to such surviving spouse's applicable exclusion amount.[285]

Sunset of EGTRRA and 2010 Extension Act estate and gift tax provisions

The estate, gift, and generation skipping transfer tax provisions of EGTRRA, as extended and modified by the 2010 Extension Act, apply for decedents dying, generation skipping transfers made, and gifts made before 2013. For transfers after December 31, 2012, the law scheduled to be in effect prior to the enactment of EGTRRA will apply. In general, this includes: (1) an estate and gift tax applicable exclusion amount of $1 million; (2) a top estate and gift tax rate of 55 percent; (3) no portability of unused exclusion between spouses; (4) a credit (rather than a deduction) for certain death taxes paid to any State or the District of Columbia; and (5) expiration of the special rules enacted under EGTRRA relating to allocation of generation skipping transfer tax exemption, estate tax conservation easements, and installment payments of estate taxes.

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[282] Sec. 2010.

[283] Pub. L. No. 111–312. Title III of the 2010 Extension Act generally extended and modified the estate and gift tax provisions of EGTRRA.

[284] See Subtitles F, G and H of Title V of EGTRRA.

[285] Sec. 2010(c). The provision does not allow a surviving spouse to use the unused generation skipping transfer tax exemption of a predeceased spouse.

Explanation of Provision

The Act makes permanent the estate and gift tax provisions of EGTRRA, as extended and modified by the 2010 Extension Act, with the modifications described below. For 2013, the inflation-indexed estate and gift tax applicable exclusion amount is $5.25 million.

The Act increases the top estate and gift tax rate to 40 percent and makes a technical correction to the portability provision.[286]

Effective Date

The provision generally is effective for decedents dying, generation skipping transfers made, and gifts made after December 31, 2012.

The technical correction to the portability provision is effective as if included in the 2010 Extension Act (i.e., effective for decedents dying after December 31, 2010).

B. Permanent Extension of 2003 Tax Relief; 20-Percent Capital Gains Rate for Certain High Income Individuals (sec. 102 of the Act and secs. 1 and 55 of the Code)

Present Law

Capital gains

In general

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual generally is taxed at rates lower than rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to $3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or

[286] Section 2010(c)(4)(B)(i) is amended replacing "basic exclusion amount" with "applicable exclusion amount" to reflect the original intent of the statute. See, Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 111th Congress* (JCS–2–11), March 2011; and Joint Committee on Taxation, *ERRATA—General Explanation of Tax Legislation Enacted in the 111th Congress* (JCX–20–11), March 2011.

business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Tax rates before 2013

Under present law, for taxable years beginning before January 1, 2013, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. Any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero rate. These rates apply for purposes of both the regular tax and the AMT.

Under present law, the "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the excess of the sum of the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) and the amount of gain equal to the additional amount of gain that would be excluded from gross income under section 1202 (relating to certain small business stock) if the percentage limitations of section 1202(a) did not apply, over the sum of the net short-term capital loss for the taxable year and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

An individual's unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

Tax rates after 2012

For taxable years beginning after December 31, 2012, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. Any adjusted net capital gain which otherwise would be taxed at the 15-percent rate is taxed at a 10-percent rate.

In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10-percent capital gain rate is taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which began after December 31, 2000, that would otherwise have been taxed at a 20-percent rate is taxed at an 18-percent rate.

The tax rates on 28-percent gain and unrecaptured section 1250 gain are the same as for taxable years beginning before 2013.

For taxable years beginning after December 31, 2012, a tax is imposed on net investment income (which includes net gain included in gross income from the disposition of property other than certain property held in a trade or business) in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

Dividends

In general

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits.

Tax rates before 2013

An individual's qualified dividend income is taxed at the same rates that apply to net capital gain. This treatment applies for purposes of both the regular tax and the alternative minimum tax. Thus, for taxable years beginning before 2013, an individual's qualified dividend income is taxed at rates of zero and 15 percent. The zero-percent rate applies to qualified dividend income which otherwise would be taxed at a 10- or 15-percent rate if the special rates did not apply.

Qualified dividend income generally includes dividends received from domestic corporations and qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

Special rules apply in determining a taxpayer's foreign tax credit limitation under section 904 in the case of qualified dividend income. For these purposes, rules similar to the rules of section 904(b)(2)(B) concerning adjustments to the foreign tax credit limitation to reflect any capital gain rate differential will apply to any qualified dividend income.

If a taxpayer receives an extraordinary dividend (within the meaning of section 1059(c)) eligible for the reduced rates with respect to any share of stock, any loss on the sale of the stock is treated as a long-term capital loss to the extent of the dividend.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the RIC is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (1) the qualified dividend income of the RIC for the taxable year and (2) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of dividends qualifying for reduced rates that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (1) the qualified dividend income of the REIT for the taxable year, (2) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (3) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

The reduced rates do not apply to dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities.[287]

Tax rates after 2012

For taxable years beginning after 2012, all dividends received by an individual are taxed at ordinary income tax rates.

For taxable years beginning after December 31, 2012, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes dividends, or the excess of modified adjusted gross income over the threshold

[287] In addition, for taxable years beginning before 2013, amounts treated as ordinary income on the disposition of certain preferred stock (sec. 306) are treated as dividends for purposes of applying the reduced rates; the tax rate for the accumulated earnings tax (sec. 531) and the personal holding company tax (sec. 541) is reduced to 15 percent; and the collapsible corporation rules (sec. 341) are repealed.

amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

Explanation of Provision

Under the Act, the tax rates in effect before 2013 for adjusted net capital gain and qualified dividend income are made permanent, except that the 15-percent rate applies only to adjusted net capital gain and qualified dividend income which otherwise would be taxed at a rate below 39.6 percent under the regular tax. A 20-percent rate applies to amounts which would otherwise be taxed at a 39.6-percent rate.[288] These rates apply for purposes of both the regular tax and the alternative minimum tax. Thus, tax rates of 0, 15, and 20 percent apply to this income. The Act does not change the tax on net investment income.

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

C. Extension of 2009 Tax Relief (sec. 103 of the Act)

1. Extension of the American opportunity credit (sec. 25A of the Code)

Present Law

Hope Scholarship credit

For taxable years beginning before 2009 and after 2012, individual taxpayers are allowed to claim a nonrefundable credit, the Hope Scholarship credit (the "Hope credit"), against Federal income taxes of up to $1,800 (for 2008) per eligible student per year for qualified tuition and related expenses paid for the first two years of the student's post-secondary education in a degree or certificate program.[289] The Hope credit rate is 100 percent on the first $1,200 of qualified tuition and related expenses, and 50 percent on the next $1,200 of qualified tuition and related expenses; these dollar amounts are indexed for inflation, with the amount rounded down to the next lowest multiple of $100. Thus, for example, a taxpayer who incurs $1,200 of qualified tuition and related expenses for an eligible student is eligible (subject to the adjusted gross income phaseout described below) for a $1,200 Hope credit. If a taxpayer incurs $2,400 of qualified tuition and related expenses for an eligible student, then he or she is eligible for a $1,800 Hope credit.

The Hope credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified AGI between $48,000 and $58,000 ($96,000 and $116,000 for married taxpayers filing a joint return) for 2008. The beginning points of the AGI phaseout ranges are indexed for inflation, with the amount rounded down to the

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[288] The provisions set forth in the preceding footnote relating to sections 306 and 341 are made permanent, and the tax rate for the accumulated earnings tax and the personal holding company tax is 20 percent.

[289] Sec. 25A. The Hope credit generally may not be claimed against a taxpayer's alternative minimum tax liability. However, the credit may be claimed against a taxpayer's alternative minimum tax liability for taxable years beginning prior to January 1, 2012.

next lowest multiple of $1,000. The size of the phaseout ranges are always $10,000 and $20,000 respectively.

The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. The Hope credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year.

The Hope credit is available in the taxable year the expenses are paid, subject to the requirement that the education is furnished to the student during that year or during an academic period beginning during the first three months of the next taxable year. Qualified tuition and related expenses paid with the proceeds of a loan generally are eligible for the Hope credit. The repayment of a loan itself is not a qualified tuition or related expense.

A taxpayer may claim the Hope credit with respect to an eligible student who is not the taxpayer or the taxpayer's spouse (e.g., in cases in which the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent, the student is not entitled to claim a Hope credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of determining the amount of qualified tuition and related expenses paid by such parent (or other taxpayer) under the provision. In addition, for each taxable year, a taxpayer may elect either the Hope credit, the Lifetime Learning credit, or an above-the-line deduction for qualified tuition and related expenses with respect to an eligible student.

The Hope credit is available for "qualified tuition and related expenses," which include tuition and fees (excluding nonacademic fees) required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under section 117 and any other tax-free educational benefits received by the student (or the taxpayer claiming the credit) during the taxable year. The Hope credit is not allowed with respect to any education expense for which a deduction is claimed under section 162 or any other section of the Code.

An eligible student for purposes of the Hope credit is an individual who is enrolled in a degree, certificate, or other program (including a program of study abroad approved for credit by the institution at which such student is enrolled) leading to a recognized educational credential at an eligible educational institution. The student must pursue a course of study on at least a half-time basis. A student is considered to pursue a course of study on at least a half-time basis if the student carries at least one half the normal full-time work load for the course of study the student is pursuing for at least one academic period that begins during the taxable year. To be eligible for the Hope credit, a student must not have been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

Eligible educational institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. To qualify as an eligible educational institution, an institution must be eligible to participate in Department of Education student aid programs.

American opportunity tax credit

The American opportunity tax credit refers to modifications to the Hope credit that apply for taxable years beginning in 2009, 2010, 2011 and 2012. The maximum allowable modified credit is $2,500 per eligible student per year for qualified tuition and related expenses paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The modified credit rate is 100 percent on the first $2,000 of qualified tuition and related expenses, and 25 percent on the next $2,000 of qualified tuition and related expenses. For purposes of the modified credit, the definition of qualified tuition and related expenses is expanded to include course materials.

Under the provision, the modified credit is available with respect to an individual student for four years, provided that the student has not completed the first four years of post-secondary education before the beginning of the fourth taxable year. Thus, the modified credit, in addition to other modifications, extends the application of the Hope credit to two more years of post-secondary education.

The modified credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for married taxpayers filing a joint return). The modified credit may be claimed against a taxpayer's AMT liability.

Forty percent of a taxpayer's otherwise allowable modified credit is refundable. However, no portion of the modified credit is refundable if the taxpayer claiming the credit is a child to whom section 1(g) applies for such taxable year (generally, any child who has at least one living parent, does not file a joint return, and is either under age 18 or under age 24 and a student providing less than one-half of his or her own support).

Bona fide residents of the U.S. possessions are not permitted to claim the refundable portion of the modified credit in the United States. Rather, a bona fide resident of a mirror code possession (Commonwealth of the Northern Mariana Islands, Guam, and the

Virgin Islands) may claim the refundable portion of the credit in the possession in which the individual is a resident. Similarly, a bona fide resident of a non-mirror code possession (Commonwealth of Puerto Rico and American Samoa) may claim the refundable portion of the credit in the possession in which the individual is resident, but only if the possession establishes a plan for permitting the claim under its internal law. The U.S. Treasury will make payments to the possession in respect of credits allowable to their residents under their internal laws.

Explanation of Provision

The provision extends for five years (through 2017) the temporary modifications to the Hope credit that are known as the American opportunity tax credit, including the rules governing the treatment of the U.S. possessions.

Effective Date

The provision is effective for taxable years beginning after December 31, 2012.

2. Extension of reduced earnings threshold for additional child tax credit (sec. 24 of the Code)

An individual may claim a tax credit for each qualifying child under the age of 17. The maximum amount of the credit per child is $1,000 through 2012 and $500 thereafter. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable aggregate child tax credit amount is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("modified AGI") over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified AGI includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against the regular tax and, for taxable years beginning before January 1, 2013, is allowed against the alternative minimum tax ("AMT"). To the extent the child tax credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). EGTRRA provided, in general, that this threshold dollar amount is $10,000 indexed for inflation from 2001. The American Recovery and Reinvestment Act, as extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("2010 Extension Act")[290] set the threshold at $3,000 for taxable years 2009 to 2012. After 2012, the ability to determine the refundable child credit based on earned income in excess of the threshold dollar amount expires.

[290] Pub. L. No. 111–312.

Families with three or more qualifying children may determine the additional child tax credit using the “alternative formula” if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer’s social security taxes exceed the taxpayer’s earned income tax credit (“EITC”). After 2012, due to the expiration of the earned income formula, this is the only manner of obtaining a refundable child credit.

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EITC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers’ parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EITC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Explanation of Provision

The provision extends for five years the earned income threshold of $3,000.

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

3. Extension of modification of the earned income tax credit (sec. 32 of the Code)

Present Law

Overview

Low- and moderate-income workers may be eligible for the refundable earned income tax credit (“EITC”). Eligibility for the EITC is based on earned income, adjusted gross income, investment income, filing status, number of children, and immigration and work status in the United States. The amount of the EITC is based on the presence and number of qualifying children in the worker’s family, as well as on adjusted gross income and earned income.

The EITC generally equals a specified percentage of earned income up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For taxpayers with earned income (or adjusted gross income (“AGI”), if greater) in excess of the beginning of the phaseout range, the maximum EITC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

An individual is not eligible for the EITC if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $3,200 (for 2012). This threshold is indexed for inflation. Disqualified income is the sum of: (1) interest (both taxable and tax exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gains net income; and (5) net passive income that is not self-employment income (if greater than zero).

The EITC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

Filing status

An unmarried individual may claim the EITC if he or she files as a single filer or as a head of household. Married individuals generally may not claim the EITC unless they file jointly. An exception to the joint return filing requirement applies to certain spouses who are separated. Under this exception, a married taxpayer who is separated from his or her spouse for the last six months of the taxable year is not considered to be married (and, accordingly, may file a return as head of household and claim the EITC), provided that the taxpayer maintains a household that constitutes the principal place of abode for a dependent child (including a son, stepson, daughter, stepdaughter, adopted child, or a foster child) for over half the taxable year, and pays over half the cost of maintaining the household in which he or she resides with the child during the year.

Presence of qualifying children and amount of the earned income credit

Four separate credit schedules apply: one schedule for taxpayers with no qualifying children, one schedule for taxpayers with one qualifying child, one schedule for taxpayers with two qualifying children, and one schedule for taxpayers with three or more qualifying children.[291]

Taxpayers with no qualifying children may claim a credit if they are over age 24 and below age 65. The credit is 7.65 percent of earnings up to $6,210, resulting in a maximum credit of $475 for 2011. The maximum is available for those with incomes between $6,210 and $7,770 ($12,980 if married filing jointly). The credit begins to phase out at a rate of 7.65 percent of earnings above $7,770 ($12,980 if married filing jointly) resulting in a $0 credit at $13,980 of earnings ($19,190 if married filing jointly).

Taxpayers with one qualifying child may claim a credit in 2012 of 34 percent of their earnings up to $9,320, resulting in a maximum credit of $3,169. The maximum credit is available for those with earnings between $9,320 and $17,090 ($22,300 if married filing jointly). The credit begins to phase out at a rate of 15.98 percent of earnings above $17,090 ($22,300 if married filing jointly). The credit is completely phased out at $36,920 of earnings ($42,130 if married filing jointly).

Taxpayers with two qualifying children may claim a credit in 2012 of 40 percent of earnings up to $13,090, resulting in a max-

[291] All income thresholds are indexed for inflation annually.

imum credit of $5,236. The maximum credit is available for those with earnings between $13,090 and $17,090 ($22,300 if married filing jointly). The credit begins to phase out at a rate of 21.06 percent of earnings above $17,090 ($22,300 if married filing jointly). The credit is completely phased out at $41,952 of earnings ($47,162 if married filing jointly).

A temporary provision enacted by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("2010 Extension Act")[292] allows taxpayers with three or more qualifying children to claim a credit of 45 percent for 2011 and 2012. For example, in 2012 taxpayers with three or more qualifying children may claim a credit of 45 percent of earnings up to $13,090, resulting in a maximum credit of $5,891. The maximum credit is available for those with earnings between $13,090 and $17,090 ($22,300 if married filing jointly). The credit begins to phase out at a rate of 21.06 percent of earnings above $17,090 ($22,300 if married filing jointly). The credit is completely phased out at $45,060 of earnings ($50,270 if married filing jointly).

Under a provision of the 2010 Extension Act, the phase-out thresholds for married couples were raised to an amount $5,000 (indexed for inflation from 2009) above that for other filers.[293] The increase is $5,210 for 2012.

If more than one taxpayer lives with a qualifying child, only one of these taxpayers may claim the child for purposes of the EITC. If multiple eligible taxpayers actually claim the same qualifying child, then a tiebreaker rule determines which taxpayer is entitled to the EITC with respect to the qualifying child. Any eligible taxpayer with at least one qualifying child who does not claim the EITC with respect to qualifying children due to failure to meet certain identification requirements with respect to such children (i.e., providing the name, age and taxpayer identification number of each of such children) may not claim the EITC for taxpayers without qualifying children.

Explanation of Provision

The provision extends the EITC at a rate of 45 percent for three or more qualifying children for five years (through 2017).

The provision extends the higher phase-out thresholds for married couples filing joint returns for five years (through 2017).

Effective Date

The provision applies to taxable years beginning after December 31, 2012.

[292] Pub. L. No. 111–312.

[293] A technical correction may be needed to reflect the inflation adjusted amounts for taxable years after 2010.

4. Refunds disregarded in the administration of federal programs and federally assisted programs (sec. 6409 of the Code)

Present Law

Any tax refund (or advance payment with respect to a refundable credit) made to any individual in calendar year 2010, 2011, or 2012 is not taken into account as a resource for a period of 12 months from receipt for purposes of determining the eligibility of such individual (or any other individual) for benefits or assistance (or the amount or extent of benefits or assistance) under any Federal program or under any State or local program financed in whole or in part with Federal funds.

Reasons for Change [294]

Congress believes that it continues to be important to provide an explicit uniform rule regarding the treatment of tax refunds for purposes of determining eligibility for benefits under Federal programs (or State or local programs financed with Federal funds).

Explanation of Provision

The Act makes permanent the present law provision for any tax refund (or advance payment with respect to a refundable credit) made to any individual.

Effective Date

The provision is effective for amounts received after December 31, 2012.

D. Permanent Alternative Minimum Tax Relief for Individuals (sec. 104 of the Act and secs. 26 and 55 of the Code)

Present Law

Present law imposes an alternative minimum tax ("AMT") on individuals. The AMT is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The exemption amounts are: (1) $74,450 ($45,000 in taxable years beginning after 2011) in the case of married individuals filing a joint return and surviving spouses; (2) $48,450 ($33,750 in taxable years beginning after 2011) in the case of other unmarried individuals; (3) $37,225 ($22,500 in taxable years beginning after

[294] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

2011) in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits. These credits include the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child credit, the credit for interest on certain home mortgages, the Hope Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, the credit for certain plug-in electric vehicles, the credit for alternative motor vehicles, the credit for new qualified plug-in electric drive motor vehicles, and the D.C. first-time homebuyer credit.

For taxable years beginning before 2012, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

For taxable years beginning after 2011, the nonrefundable personal credits (other than the adoption credit (for taxable years beginning after 2012), the child credit (for taxable years beginning after 2012), the Hope Scholarship credit (for taxable years beginning after 2012), the credit for savers, the credit for residential energy efficient property, the credit for certain plug-in electric vehicles, the credit for alternative motor vehicles, and the credit for new qualified plug-in electric drive motor vehicles) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit (for taxable years beginning before 2013), the child credit (for taxable years beginning before 2013), the Hope Scholarship credit (for taxable years beginning before 2013), the credit for savers, the credit for residential energy efficient property, the credit certain plug-in electric vehicles, the credit for alternative motor vehicles, and the credit for new qualified plug-in electric drive motor vehicles are allowed to the full extent of the individual's regular tax and alternative minimum tax.

Reasons for Change [295]

Congress is concerned about the projected increase in the number of individuals who will be affected by the individual alternative minimum tax and the projected increase in tax liability for those who are affected by the tax. The provision will reduce the number of individuals who would otherwise be affected by the alternative minimum tax and will reduce the tax liability of the families that continue to be affected by the alternative minimum tax.

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[295] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Explanation of Provision

The basic AMT exemption amounts for taxable years beginning in 2012 are increased to (1) $78,750 in the case of married individuals filing a joint return and surviving spouses; (2) $50,600 in the case of other unmarried individuals; and (3) $39,375 in the case of married individuals filing separate returns. For taxable years beginning after 2012, the Act indexes the following dollar amounts for inflation:

(1) The dollar amounts dividing the 26- and 28-percent rates.

(2) The dollar amounts of the basic AMT exemption.

(3) The dollar amounts at which the phase-out of the basic AMT exemption amount begins.

The Act makes permanent the provision allowing the personal credits against the AMT.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

TITLE II—INDIVIDUAL TAX EXTENDERS

1. Deduction for certain expenses of elementary and secondary school teachers (sec. 201 of the Act and sec. 62(a)(2)(D) of the Code)

Present Law

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. For taxable years beginning after 2012, an individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of a threshold amount. In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Certain expenses of eligible educators are allowed as an above-the-line deduction. Specifically, for taxable years beginning prior to January 1, 2012, an above-the-line deduction is allowed for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom.[296] To be eligible for this deduction, the expenses must be otherwise deductible under section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under section 135 (relating to education savings bonds), 529(c)(1) (relating to

[296] Sec. 62(a)(2)(D).

qualified tuition programs), and section 530(d)(2) (relating to Coverdell education savings accounts).

An eligible educator is a kindergarten through grade twelve teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. A school means any school that provides elementary education or secondary education (kindergarten through grade 12), as determined under State law.

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2011.

Reasons for Change [297]

Congress recognizes that many elementary and secondary school teachers provide substantial classroom resources at their own expense, and believe that it is appropriate to extend the present law deduction for such expenses in order to continue to partially offset the substantial costs such educators incur for the benefit of their students.

Explanation of Provision

The provision extends the deduction for eligible educator expenses for two years, through December 31, 2013.

Effective Date

The provision applies to taxable years beginning after December 31, 2011.

2. Exclude discharges of acquisition indebtedness on principal residences from gross income (sec. 202 of the Act and sec. 108 of the Code)

Present Law

In general

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108).[298] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge

[297] See S. 3521, the “Family and Business Tax Cut Certainty Act of 2012,” which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[298] A debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor (sec. 102).

over the aggregate of the liabilities of the taxpayer immediately after the discharge (sec. 1017).

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

Qualified principal residence indebtedness

An exclusion from gross income is provided for any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness.Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B), except that the dollar limitation is $2 million) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. For these purposes, the term "principal residence" has the same meaning as under section 121 of the Code.

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of $1 million, of which $800,000 is qualified principal residence indebtedness. If the residence is sold for $700,000 and $300,000 debt is discharged, then only $100,000 of the amount discharged may be excluded from gross income under the qualified principal residence indebtedness exclusion.

The basis of the individual's principal residence is reduced by the amount excluded from income under the provision.

The qualified principal residence indebtedness exclusion does not apply to a taxpayer in a Title 11 case; instead the general exclusion rules apply. In the case of an insolvent taxpayer not in a Title 11 case, the qualified principal residence indebtedness exclusion applies unless the taxpayer elects to have the general exclusion rules apply instead.

The exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

The exclusion for qualified principal residence indebtedness is effective for discharges of indebtedness before January 1, 2013.

Reasons for Change[299]

Congress believes that where a lender discharges acquisition debt on a principal residence such as is the case of a short sale or when a taxpayer loses their principal residence through a foreclosure, it is inappropriate to treat discharges of indebtedness as income.

Explanation of Provision

The provision extends for one additional year (through December 31, 2013) the exclusion from gross income for discharges of qualified principal residence indebtedness.

Effective Date

The provision applies to discharges of indebtedness on or after January 1, 2013.

3. Parity for mass transit and parking benefits (sec. 203 of the Act and sec. 132(f) of the Code)

Present Law

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income for income tax purposes and from an employee's wages for employment tax purposes.[300] Qualified transportation fringe benefits include parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. No amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits (other than a qualified bicycle commuting reimbursement). Qualified transportation fringe benefits also include a cash reimbursement (under a bona fide reimbursement arrangement) by an employer to an employee for parking, transit passes, or vanpooling. In the case of transit passes, however, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item that may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

Before February 17, 2009, the amount that could be excluded as qualified transportation fringe benefits was limited to $100 per month in combined transit pass and vanpool benefits and $175 per month in qualified parking benefits. These limits are adjusted annually for inflation, using 1998 as the base year; for 2012 the limits are $125 and $240, respectively. The American Recovery and Reinvestment Act of 2009[301] provided parity in qualified transportation fringe benefits by temporarily increasing the monthly exclusion for combined employer-provided transit pass and vanpool benefits to the same level as the exclusion for employer-provided parking, effective for months beginning on or after the date of enactment (February 17, 2009) and before January 1, 2011. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of

[299] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[300] Secs. 132(a)(5) and (f), 3121(a)(20), 3231(e)(5), 3306(b)(16) and 3401(a)(19).

[301] Pub. L. No. 111–5.

2010[302] extended parity in qualified transportation fringe benefits through December 31, 2011.

Effective January 1, 2012, the amount that can be excluded as qualified transportation fringe benefits is limited to $125 per month in combined transit pass and vanpool benefits and $240 per month in qualified parking benefits.

Reasons for Change[303]

Maintaining parity in transportation benefits provides employees with an incentive to use public transportation and vanpools for their commute rather than driving to work in their personal vehicles, thus potentially easing traffic congestion and pollution.

Explanation of Provision

The provision extends parity in qualified transportation fringe benefits through December 31, 2013. Thus, for 2012, the monthly limit on the exclusion for combined transit pass and vanpool benefits is $240.

In order for the extension to be effective retroactive to January 1, 2012, expenses incurred during 2012 by an employee for employer-provided vanpool and transit benefits may be reimbursed (under a bona fide reimbursement arrangement) by employers on a tax-free basis to the extent they exceed $125 per month and are less than $240 per month. Congress intends that the rule that an employer reimbursement is excludible only if vouchers are not available to provide the benefit shall continue to apply, except in the case of reimbursements for vanpool or transit benefits between $125 and $240 for months during 2012. Further, Congress intends that reimbursements for expenses incurred for months during 2012 may be made in addition to the provision of benefits or reimbursements of up to $245 per month for expenses incurred during 2013.

Effective Date

The provision applies to months after December 31, 2011.

4. Mortgage insurance premiums (sec. 204 of the Act and sec. 163 of the Code)

Present Law

In general

Present law provides that qualified residence interest is deductible notwithstanding the general rule that personal interest is nondeductible (sec. 163(h)).

Acquisition indebtedness and home equity indebtedness

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is $100,000. The maximum amount of acquisi-

[302] Pub. L. No. 111–312.

[303] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

tion indebtedness is $1 million. Acquisition indebtedness means debt that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

Private mortgage insurance

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of married individual filing a separate return).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration,[304] and private mortgage insurance (defined in section two of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Service).

The provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates for any amount paid or accrued after December 31, 2011, or properly allocable to any period after that date.

Reporting rules apply under the provision.

Reasons for Change[305]

Congress believes it is appropriate to extend the present-law temporary provision. Congress understands that the purpose of the provisions permitting deduction of home mortgage interest is to encourage home ownership while limiting significant disincentives to saving. Congress believes that it would be consistent with the purpose of the provisions permitting deduction of home mortgage interest to permit the deduction of mortgage insurance premiums. While these premiums are not in the nature of interest, Congress

[304] The Veterans Administration and the Rural Housing Administration have been succeeded by the Department of Veterans Affairs and the Rural Housing Service, respectively.

[305] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

notes that purchase of such insurance is often demanded by lenders in order for home buyers to obtain financing (depending on the size of the buyer's down payment). Congress believes that permitting deductibility of premiums for this type of insurance connected with home purchases will foster home ownership. In the case of higher income taxpayers who may not purchase mortgage insurance, however, Congress believes the incentive of deductibility becomes unnecessary, and a phase-out is appropriate. It is not intended that prepayments be currently deductible, but rather, that they be deductible only in the period to which they relate. Reporting of payments is generally necessary to administer the provision.

Explanation of Provision

The provision extends the deduction for private mortgage insurance premiums for two years (with respect to contracts entered into after December 31, 2006). Thus, the provision applies to amounts paid or accrued in 2012 and 2013 (and not properly allocable to any period after 2013).[306]

Effective Date

The provision applies to amounts paid or accrued after December 31, 2011.

5. Deduction for State and local sales taxes (sec. 205 of the Act and sec. 164 of the Code)

Present Law

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning before 2012, at the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes. As is the case for State and local income taxes, the itemized deduction for State and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account number of dependents, modified adjusted gross income and rates of State and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. Taxpayers who use the tables created by the Secretary may, in addition to the

[306] The provision corrects the names of the Department of Veterans Affairs and the Rural Housing Service.

table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats, and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

A general sales tax is a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items.[307] No deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of food, clothing, medical supplies, and motor vehicles, the above rules are relaxed in two ways. First, if the tax does not apply with respect to some or all of such items, a tax that applies to other such items can still be considered a general sales tax. Second, the rate of tax applicable with respect to some or all of these items may be lower than the general rate. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess is disregarded and the general rate is treated as the rate of tax.

A compensating use tax with respect to an item is treated as a general sales tax, provided such tax is complementary to a general sales tax and a deduction for sales taxes is allowable with respect to items sold at retail in the taxing jurisdiction that are similar to such item.

Reasons for Change[308]

Congress believes an extension of the option to deduct State and local sales taxes in lieu of deducting State and local income taxes is appropriate to continue to provide similar Federal tax treatment to residents of States that rely on sales taxes, rather than income taxes, to fund State and local governmental functions.

Explanation of Provision

The provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes is extended for two years, through 2013.

Effective Date

The provision applies to taxable years beginning after December 31, 2011.

6. Contributions of capital gain real property made for conservation purposes (sec. 206 of the Act and sec. 170 of the Code)

Present Law

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contrib-

[307] Sec. 164(b)(5)(B).

[308] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

uted property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[309]

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks. Total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations generally may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to most private nonoperating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions in excess of the applicable percentage limits generally may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

Capital gain property

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

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[309] Secs. 170, 2055, and 2522, respectively.

Qualified conservation contributions

Qualified conservation contributions are one exception to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property.[310] A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Qualified conservation contributions of capital gain property are subject to the same limitations and carryover rules as other charitable contributions of capital gain property.

Temporary rules regarding contributions of capital gain real property for conservation purposes

In general

Under a temporary provision[311] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

Individuals are allowed to carry over any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years.

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carry over the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation con-

[310] Secs. 170(f)(3)(B)(iii) and 170(h).
[311] Sec. 170(b)(1)(E).

tribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and ranchers

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the above example, if the individual is a qualified farmer or rancher, in addition to the $50 deduction for non-conservation contributions, an additional $50 for the qualified conservation contribution is allowed and $30 may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[312]

As an additional condition of eligibility for the 100 percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.)

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

Termination

The temporary rules regarding contributions of capital gain real property for conservation purposes do not apply to contributions made in taxable years beginning after December 31, 2011.[313]

Reasons for Change[314]

Congress believes that the special rule that provides an increased incentive to make charitable contributions of partial interests in real property for conservation purposes is an important way of encouraging conservation and preservation, and should be extended for two additional years.

[312] Sec. 170(b)(2)(B).

[313] Secs. 170(b)(1)(E)(vi) and 170(b)(2)(B)(iii).

[314] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Explanation of Provision

The provision extends the temporary rules regarding contributions of capital gain real property for conservation purposes for two years for contributions made in taxable years beginning before January 1, 2014.

Effective Date

The provision applies to contributions made in taxable years beginning after December 31, 2011.

7. Deduction for qualified tuition and related expenses (sec. 207 of the Act and sec. 222 of the Code)

Present Law

An individual is allowed a deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[315] The deduction is allowed in computing adjusted gross income. The term qualified tuition and related expenses is defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution.[316] The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2011.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual,[317] and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings ac-

[315] Sec. 222.

[316] The deduction generally is not available for expenses with respect to a course or education involving sports, games, or hobbies, and is not available for student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

[317] Secs. 222(d)(1) and 25A(g)(2).

count.[318] Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion under section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

Reasons for Change[319]

Congress observes that the cost of a college education continues to rise, and thus believes that the extension of the qualified tuition deduction is appropriate to mitigate the impact of rising tuition costs on students and their families. Congress further believes that the tuition deduction provides an important financial incentive for individuals to pursue higher education.

Explanation of Provision

The provision extends the qualified tuition deduction for two years, through 2013.

Effective Date

The provision applies to taxable years beginning after December 31, 2011.

8. Tax-free distributions from individual retirement plans for charitable purposes (sec. 208 of the Act and sec. 408 of the Code)

Present Law

In general

If an amount withdrawn from a traditional individual retirement arrangement ("IRA") or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply to the amount withdrawn and the charitable contribution is subject to the normally applicable limitations on deductibility of such contributions. An exception applies in the case of a qualified charitable distribution.

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to the following entities: (1) a charity described in section 170(c)(2); (2) certain veterans' organizations, fraternal societies, and cemetery companies;[320] and (3) a Federal, State, or local governmental entity, but only if the contribution is made for exclusively public pur-

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[318] Sec. 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.

[319] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[320] Secs. 170(c)(3)-(5).

poses.[321] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property 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.[322]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[323]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service provided) to the taxpayer in consideration for the contribution.[324] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[325]

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations generally may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to most private nonoperating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions by individuals in excess of the 50-percent, 30-percent, and 20-percent limits generally may be carried over and de-

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[321] Sec. 170(c)(1).

[322] Secs. 170(b) and (e).

[323] Sec. 170(a).

[324] Sec. 170(f)(8). For any contribution of a cash, check, or other monetary gift, no deduction is allowed unless the donor maintains as a record of such contribution a bank record or written communication from the donee charity showing the name of the donee organization, the date of the contribution, and the amount of the contribution. Sec. 170(f)(17).

[325] Sec. 6115.

ducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[326] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[327] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Certain individuals also may make nondeductible contributions to a Roth IRA (deductible contributions cannot be made to Roth IRAs). Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by April 1 of the calendar year following the year in which the IRA owner attains age 70½.[328]

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the remaining nondeductible contributions to the account balance. In making the calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during any taxable year are treated as a single distribution, and the value of the contract, income on the contract, and investment in the contract are computed as of the close of the calendar year.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA con-

[326] Secs. 170(f), 2055(e)(2), and 2522(c)(2).
[327] Sec. 170(f)(2).
[328] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

tributions; (2) taxable conversion contributions;[329] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[330] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

Qualified charitable distributions

Under a temporary provision applicable for taxable years beginning before January 1, 2012, otherwise taxable IRA distributions from a traditional or Roth IRA are excluded from gross income to the extent they are qualified charitable distributions.[331] The exclusion may not exceed $100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. A qualified charitable distribution is taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA as a result of qualified charitable distributions being made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (other than an organization described in section 509(a)(3) or a donor advised fund (as defined in section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½ and only to the extent the distribution would be includible in gross income (without regard to this provision).

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income (but for the qualified

[329] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.
[330] Sec. 3405.
[331] Sec. 408(d)(8). The exclusion does not apply to distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

charitable distribution provision) and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income (but for the qualified charitable distribution provision) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under section 170.

Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2011.

Reasons for Change [332]

Congress believes that facilitating charitable contributions from IRAs will increase giving to charitable organizations. Therefore, Congress believes that the exclusion for qualified charitable distributions should be extended for two years.

Explanation of Provision

The provision extends the exclusion for qualified charitable distributions for two years, to distributions made in taxable years beginning before January 1, 2014.

Effective Date

The provision is effective for distributions made in taxable years beginning after December 31, 2011.

The provision contains two special rules. First, the provision permits taxpayers to elect (in such form and manner as the Secretary may prescribe) to have qualified charitable distributions made in January 2013 treated as having been made on December 31, 2012 for purposes of sections 408(a)(6), 408(b)(3), and 408(d)(8). Thus, a qualified charitable distribution made in January 2013 is permitted to be (1) treated as made in the taxpayer's 2012 taxable year and thus permitted to count against the 2012 $100,000 limitation on the exclusion, and (2) treated as made in the 2012 calendar year and thus permitted to be used to satisfy the taxpayer's minimum distribution requirement for 2012.

Second, the provision permits taxpayers to elect (in such form and manner as the Secretary may prescribe) to treat any portion of a distribution from an IRA that occurred after November 30, 2012 and before January 1, 2013 as a qualified charitable distribution to the extent that the following requirements are met: (1) the portion is transferred in cash, after the distribution and before February 1, 2013, to a charitable organization described in section 408(d)(8)(B)(i); and (2) the portion is part of a distribution that

[332] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

would have met the requirements of a qualified charitable distribution but for the fact that the distribution was not transferred directly to the charitable organization.

9. Improve and make permanent the provision authorizing the Internal Revenue Service to disclose certain return and return information to certain prison officials (sec. 209 of the Act and sec. 6103 of the Code)

Present Law

Section 6103 provides that returns and return information are confidential and may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in the Code.[333] A "return" is any tax or information return, declaration of estimated tax, or claim for refund required by, or permitted under, the Code, that is filed with the Secretary by, on behalf of, or with respect to any person.[334] "Return" also includes any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

The definition of "return information" is very broad and includes any information gathered by the IRS with respect to a person's liability or possible liability under the Code.[335]

However, data in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer is not "return information" for section 6103 purposes.

Section 6103 contains a number of exceptions to the general rule of confidentiality, which permit disclosure in specifically identified circumstances when certain conditions are satisfied.[336] For example, one exception permits disclosure to the head of the Federal Bureau of Prisons and to the head of a State agency charged with administration of a State prison of return information with respect to prisoners whom the Secretary has determined may have filed or facilitated the filing of false or fraudulent tax returns. Such informa-

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[333] Sec. 6103(a).

[334] Sec. 6103(b)(1).

[335] Sec. 6103(b)(2). Return information is:

- a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense,
- any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,
- any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and
- any closing agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement.

[336] Sec. 6103(c)–(o). Such exceptions include disclosures by consent of the taxpayer, disclosures to State tax officials, disclosures to the taxpayer and persons having a material interest, disclosures committees of Congress, disclosures to the President, disclosures to Federal employees for tax administration purposes, disclosures to Federal employees for nontax criminal law enforcement purposes and to the Government Accountability Office, disclosures for statistical purposes, disclosures for miscellaneous tax administration purposes, disclosures for purposes other than tax administration, disclosures of taxpayer identity information, disclosures to tax administration contractors and disclosures with respect to wagering excise taxes.

tion may be redisclosed to officers and employees of such Bureau or agency. The Secretary may disclose only such information as is necessary to permit effective tax administration with respect to prisoners. The disclosure authority expired December 31, 2011.

Reasons for Change [337]

Congress believes that sharing information with prison officials will allow the prison officials to take appropriate disciplinary and administrative action to deter prisoners from filing false Federal tax returns. As many State prisons are run on a contract basis, and the IRS has identified a number of these prisons as sources of false returns, Congress believes that equal disclosure authority should be afforded to such prison officials to address the matter. Permitting the disclosure of information directly to the officers and employees responsible for disciplining prisoners could improve efficiency. In addition, providing prison officials with a full copy of the false return, showing the prisoner's signature, is more likely to satisfy the burden of proof that a prisoner filed the false return.

Explanation of Provision

The provision makes permanent the authority of the IRS to disclose tax information relating to prisioner misconduct to the Federal Bureau of Prisons and State prison officials. In addition, the provision (1) authorizes the disclosure of actual returns (not just return information), (2) allows the disclosure to be made directly to officers and employees of the prison agency rather than through the head of such agency, (3) allows redisclosure of return information to contractors that operate prisons, and (4) clarifies the authority for the disclosure to, and use by, legal representatives in proceedings.

Effective Date

The provision applies to disclosures made on or after the date of enactment.

TITLE III—BUSINESS TAX EXTENDERS

1. Research credit (sec. 301 of the Act and sec. 41 of the Code)

Present Law

General rule

For general research expenditures, a taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.[338] Thus, the research credit generally is available with respect to incremental increases in qualified research. An alternative simplified research credit (with a 14 percent

[337] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).
[338] Sec. 41.

rate and a different base amount) may be claimed in lieu of this credit.

A 20-percent research credit is also available with respect to the excess of (1) 100 percent of corporate cash expenses (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.[339]

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium. This separate credit computation is commonly referred to as the energy research credit. Unlike the other research credits, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit, including the university basic research credit and the energy research credit, is not available for amounts paid or incurred after December 31, 2011.[340]

Computation of allowable credit

Except for energy research payments and certain university basic research payments made by corporations, the research credit applies only to the extent that the taxpayer's qualified research expenses 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 expenses 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 expenses for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). Special rules apply to all other taxpayers (so called start-up firms).[341] In computing the credit, a taxpayer's base amount cannot be less than 50 percent of its current-year qualified research expenses.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, a special aggregation rule provides that all members of the same controlled group of corporations or all members of a group of

[339] Sec. 41(e).

[340] Sec. 41(h).

[341] The Small Business Job Protection Act of 1996 expanded 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. A special rule (enacted in 1993) is 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 is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).

businesses under common control are treated as a single taxpayer.[342] The credit allowable to each member is its proportionate share of the qualified research expenses, basic research payments, and energy research payments giving rise to the credit.

Under regulations prescribed by the Secretary, special rules apply for computing the research credit when a major portion of a trade or business (or unit thereof) changes hands. Under these rules, qualified research expenses and gross receipts arising in taxable years prior to the change of ownership of a trade or business are treated as transferred to the acquiring taxpayer with the trade or business that gave rise to those expenses and receipts for purposes of recomputing the acquiring taxpayer's fixed-base percentage.[343] Qualified research expenses incurred during the taxable year including or ending with a change of ownership are treated as transferred to the acquiring taxpayer with the trade or business for purposes of determining the credit for the acquiring taxpayer's first taxable year including the acquisition.

Alternative simplified credit

The alternative simplified research credit is equal to 14 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to six percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years. An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary.

Eligible expenses

Qualified research expenses 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 or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called contract research expenses).[344] Notwithstanding the limitation for contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or Federal laboratory for qualified energy research.

To be eligible for the credit, the research not only has to satisfy the requirements of present-law section 174 (described below) but also 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 substantially all of the activities of which constitute elements of a process of experimentation for func-

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[342] Sec. 41(f)(1).

[343] Sec. 41(f)(3).

[344] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. Sec. 41(b)(3)(C).

tional 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.[345] In addition, research does not qualify for the credit if: (1) conducted after the beginning of commercial production of the business component; (2) related to the adaptation of an existing business component to a particular customer's requirements; (3) related to the duplication of an existing business component from a physical examination of the component itself or certain other information; (4) related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control; (5) related to software developed primarily for internal use by the taxpayer; (6) related to social sciences, arts, or humanities; or (7) funded by any grant, contract, or otherwise by another person (or governmental entity).[346] Research does not qualify for the credit if it is conducted outside the United States, Puerto Rico, or any U.S. possession.

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures paid or incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized.[347] However, deductions 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.[348] Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.[349]

Reasons for Change[350]

Congress acknowledges that research is important to the economy. Research is the basis of new products, new services, new industries, and new jobs for the domestic economy. There can be cases where an individual business may not find it profitable to invest in research as much as it otherwise might because it is difficult to capture the full benefits from the research and prevent such benefits from being used by competitors. At the same time, the research may create great benefits that spill over to society at large. To encourage activities that will result in these spillover benefits to society at large, the government does act to promote research. Therefore Congress believes it is appropriate to extend the present-law research credit.

Congress further believes that technical changes are necessary (1) to ensure that when a business changes hands, the disposing

[345] Sec. 41(d)(3).
[346] Sec. 41(d)(4).
[347] Taxpayers may elect 10-year amortization of certain research expenditures allowable as a deduction under section 174(a). Secs. 174(f)(2) and 59(e).
[348] Sec. 280C(c).
[349] Sec. 280C(c)(3).
[350] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

business entity receives the research credit for expenses incurred prior to the date of a change in ownership, and (2) to simplify the allocation of research expenses among commonly controlled groups of businesses.

Explanation of Provision

The provision extends the research credit for two years (through 2013). Under the provision, the special rules for taxpayers under common control and the special rules for computing the credit when a major portion of a trade or business (or unit thereof) changes hands are modified. Qualified research expenses paid or incurred by the disposing taxpayer in a taxable year that includes or ends with a change in ownership are treated as current year qualified research expenses of the disposing taxpayer and such expenses are not treated as current year qualified research expenses of the acquiring taxpayer. Further, the disposing taxpayer's and acquiring taxpayer's base period amounts are adjusted by a pro-rated amount. In addition, the credit allowable to each member of a controlled group of corporations or each member of a group of businesses under common control is determined on a proportionate basis to its share of the current year aggregate qualified research expenses (i.e., the gross qualified research expense allocation method).[351]

Effective Date

The extension of the credit is effective for amounts paid or incurred after December 31, 2011. The modifications to the special rules are effective for taxable years beginning after December 31, 2011.

2. Determination of applicable percentage for the low-income housing tax credit (sec. 302 of the Act and sec. 42 of the Code)

Present Law

In general

The low-income housing credit may be claimed over a 10-year credit period after each low-income building is placed-in-service. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building.

Present value credit

The calculation of the applicable percentage is designed to produce a credit equal to: (1) 70 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is not Federally subsidized (the "70-percent credit"); or (2) 30 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is Federally subsidized and

[351] The provision overturns the stand-alone entity credit approach contained in Treas. Reg. sec. 1.41–6(c).

existing housing that is substantially rehabilitated (the "30-percent credit"). Where existing housing is substantially rehabilitated, the existing housing is eligible for the 30-percent credit and the qualified rehabilitation expenses (if not Federally subsidized) are eligible for the 70-percent credit.

Calculation of the applicable percentage

In general

The credit percentage for a low-income building is set for the earlier of: (1) the month the building is placed in service; or (2) at the election of the taxpayer, (a) the month the taxpayer and the housing credit agency enter into a binding agreement with respect to such building for a credit allocation, or (b) in the case of a tax-exempt bond-financed project for which no credit allocation is required, the month in which the tax-exempt bonds are issued.

These credit percentages (used for the 70-percent credit and 30-percent credit) are adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the Applicable Federal Rates for mid-term and long-term obligations for the month the building is placed in service. The discounting formula assumes that each credit is received on the last day of each year and that the present value is computed on the last day of the first year. In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.

Special rule

Under this rule the applicable percentage is set at a minimum of 9 percent for newly constructed non-Federally subsidized buildings placed in service after July 30, 2008, and before December 31, 2013.

Reasons for Change[352]

Historically low Federal interest rates result in lower credit amounts for low-income housing tax credit properties. To reduce uncertainty and financial risk in the adjustable rate, Congress believes that an extension of the temporary minimum applicable percentage for newly constructed non-Federally subsidized building is warranted.

Explanation of Provision

The provision extends the temporary minimum applicable percentage of 9 percent for newly constructed non-Federally subsidized buildings with respect to which credit allocations are made before January 1, 2014.

Effective Date

The provision is effective on the date of enactment.

[352] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

3. Treatment of basic housing allowances for purposes of income eligibility rules (sec. 303 of the Act and secs. 42 and 142 of the Code)

Present Law

In general

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). These income figures are adjusted for family size.

Rule for income determinations before July 30, 2008 and on or after January 1, 2012

The recipients of the military basic housing allowance must include these amounts for purposes of low-income credit eligibility income test, as described above.

Special rule for income determination before January 1, 2012

Under the provision the basic housing allowance (i.e., payments under 37 U.S.C. sec. 403) is not included in income for the low-income credit income eligibility rules. The provision is limited in application to qualified buildings. A qualified building is defined as any building located:

1. any county which contains a qualified military installation to which the number of members of the Armed Forces assigned to units based out of such qualified military installation has increased by 20 percent or more as of June 1, 2008, over the personnel level on December 31, 2005; and
2. any counties adjacent to a county described in (1), above.

For these purposes, a qualified military installation is any military installation or facility with at least 1000 members of the Armed Forces assigned to it.

The provision applies to income determinations: (1) made after July 30, 2008, and before January 1, 2012, in the case of qualified buildings which received credit allocations on or before July 30, 2008, or qualified buildings placed in service on or before July 30, 2008, to the extent a credit allocation was not required with respect to such building by reason of 42(h)(4) (i.e. such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued before July 30, 2008; and (2) made after July 30, 2008, in the case of qualified buildings which received credit allocations after July 30, 2008 and before January 1, 2012, or qualified buildings placed in service after July 30, 2008, and before January 1, 2012, to the extent a credit allocation was not required with respect to such qualified building by reason of 42(h)(4) (i.e. such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued after July 30, 2008, and before January 1, 2012.

Reasons for Change [353]

Congress believes that more time is necessary for market forces to create adequate housing in communities affected by the base closing legislation. In the meantime, Congress believes that encouraging owners of low-income housing credit properties to rent such subsidized units to military families is appropriate.

Explanation of Provision

The provision extends the special rule for two additional years (through December 31, 2013).

Effective Date

The provision is effective for income determinations on or after January 1, 2012.

4. Indian employment tax credit (sec. 304 of the Act and sec. 45A of the Code)

Present Law

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees.[354] The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An "Indian reservation" is a reservation as defined in section 3(d) of the Indian Financing Act of 1974[355] or section 4(10) of the Indian Child Welfare Act of 1978.[356] For purposes of the pre-

[353] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).
[354] Sec. 45A.
[355] Pub. L. No. 93–262.
[356] Pub. L. No. 95–608.

ceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (which after adjusted for inflation is $45,000 for 2011). In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a five percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee's services relate to gaming activities or are performed in a building housing such activities.

The wage credit is available for wages paid or incurred in taxable years that begin before January 1, 2012.

Reasons for Change[357]

To further encourage employment on Indian reservations, Congress believes it is appropriate to extend the Indian employment credit an additional two years.

Explanation of Provision

The provision extends for two years the present-law employment credit provision (through taxable years beginning on or before December 31, 2013).

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

5. New markets tax credit (sec. 305 of the Act and sec. 45D of the Code)

Present Law

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[358] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years,

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[357] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[358] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106–554.

and (2) a six-percent credit for each of the following four years.[359] The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.[360] The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed.[361]

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE.[362] A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired at its original issue directly (or through an underwriter) from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder.[350] Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments and the investment must be designated as a qualified equity investment by the CDE. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.[363]

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income.[364] For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

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[359] Sec. 45D(a)(2).
[360] Sec. 45D(a)(3).
[361] Sec. 45D(g).
[362] Sec. 45D(c).
[363] Sec. 45D(d).
[364] Sec. 45D(e).

The Secretary is authorized to designate "targeted populations" as low-income communities for purposes of the new markets tax credit.[365] For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994[366] (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of—80 percent of the area median family income, or 80 percent of the statewide non-metropolitan area median family income.[367] A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391 of the Code, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of the business is used in a low-income community; (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of the business is attributable to certain financial property or to certain collectibles.[368]

The maximum annual amount of qualified equity investments was $3.5 billion for calendar years 2010 and 2011. The new markets tax credit expired on December 31, 2011.

Reasons for Change[369]

Congress believes that the new markets tax credit has proved to be an effective means of providing equity and other investments to benefit businesses in low income communities, and that it is appropriate to provide for the allocation of additional tax credit authority for another two calendar years.

Explanation of Provision

The provision extends the new markets tax credit for two years, through 2013, permitting up to $3.5 billion in qualified equity investments for each of the 2012 and 2013 calendar years. The provi-

[365] Sec. 45D(e)(2).
[366] Pub. L. No. 103–325.
[367] Pub. L. No. 103–325.
[368] Sec. 45D(d)(2).
[369] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

sion also extends for two years, through 2018, the carryover period for unused new markets tax credits.

Effective Date

The provision applies to calendar years beginning after December 31, 2011.

6. Railroad track maintenance credit (sec. 306 of the Act and sec. 45G of the Code)

Present Law

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during taxable years beginning before January 1, 2012.[370] The credit is limited to the product of $3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year, and (2) assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the taxable year.[371] Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. The credit also may reduce a taxpayer's tax liability below its tentative minimum tax.[372]

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).[373]

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only with respect to miles of railroad track assigned to such person by such railroad under the provision.[374]

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.[375]

Reasons for Change[376]

Congress believes that Class II and Class III railroads are an important part of the nation's railway system. Therefore, Congress believes that this incentive for railroad track maintenance expenditures should be extended.

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[370] Secs. 45G(a) and (f).
[371] Sec. 45G(b)(1).
[372] Sec. 38(c)(4).
[373] Sec. 45G(d).
[374] Sec. 45G(c).
[375] Sec. 45G(e)(1).
[376] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Explanation of Provision

The provision extends the present law credit for two years, for qualified railroad track maintenance expenses paid or incurred during taxable years beginning after December 31, 2011, and before January 1, 2014.

Effective Date

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2011.

7. Mine rescue team training credit (sec. 307 of the Act and sec. 45N of the Code)

Present Law

An eligible employer may claim a general business credit against income tax with respect to each qualified mine rescue team employee equal to the lesser of: (1) 20 percent of the amount paid or incurred by the taxpayer during the taxable year with respect to the training program costs of the qualified mine rescue team employee (including the wages of the employee while attending the program); or (2) $10,000. A qualified mine rescue team employee is any full-time employee of the taxpayer who is a miner eligible for more than six months of a taxable year to serve as a mine rescue team member by virtue of either having completed the initial 20 hour course of instruction prescribed by the Mine Safety and Health Administration's Office of Educational Policy and Development, or receiving at least 40 hours of refresher training in such instruction. The credit is not allowable for purposes of computing the alternative minimum tax.[377]

An eligible employer is any taxpayer which employs individuals as miners in underground mines in the United States. The term "wages" has the meaning given to such term by section 3306(b)[378] (determined without regard to any dollar limitation contained in that section).

No deduction is allowed for the portion of the expenses otherwise deductible that is equal to the amount of the credit.[379] The credit does not apply to taxable years beginning after December 31, 2011. Additionally, the credit may not offset the alternative minimum tax.

Reasons for Change[380]

Congress believes that training mine rescue team employees will help ensure a positive outcome for individuals operating in and around a mine in the event of an accident. Therefore, Congress believes that this incentive for costs incurred to train mine rescue teams should be extended.

[377] Sec. 38(c).
[378] Section 3306(b) defines wages for purposes of Federal Unemployment Tax.
[379] Sec. 280C(e).
[380] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Explanation of Provision

The provision extends the credit for two years through taxable years beginning on or before December 31, 2013.

Effective Date

The provision generally is effective for taxable years beginning after December 31, 2011.

8. Employer wage credit for employees who are active duty members of the uniformed services (sec. 308 of the Act and sec. 45P of the Code)

Present Law

Differential pay

In general, compensation paid by an employer to an employee is deductible by the employer under section 162(a)(1), unless the expense must be capitalized. In the case of an employee who is called to active duty with respect to the armed forces of the United States, some employers voluntarily pay the employee the difference between the compensation that the employer would have paid to the employee during the period of military service less the amount of pay received by the employee from the military. This payment by the employer is often referred to as "differential pay."

Wage credit for differential pay

If an employer qualifies as an eligible small business employer, the employer is allowed to take a credit against its income tax liability for a taxable year in an amount equal to 20 percent of the sum of the eligible differential wage payments for each of the employer's qualified employees for the taxable year.[381]

An eligible small business employer means, with respect to a taxable year, any taxpayer which: (1) employed on average less than 50 employees on business days during the taxable year; and (2) under a written plan of the taxpayer, provides eligible differential wage payments to every qualified employee of the taxpayer. Taxpayers under common control are aggregated for purposes of determining whether a taxpayer is an eligible small business employer. The credit is not available with respect to a taxpayer who has failed to comply with the employment and reemployment rights of members of the uniformed services (as provided under Chapter 43 of Title 38 of the United States Code).

Differential wage payment means any payment which: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services of the United States while on active duty for a period of more than 30 days; and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer. The term eligible differential wage payments means so much of the differential wage payments paid to a qualified employee as does not exceed $20,000. A qualified employee is an individual who has been an

[381] Sec. 45P.

employee for the 91-day period immediately preceding the period for which any differential wage payment is made.

No deduction may be taken for that portion of compensation which is equal to the credit. In addition, the amount of any other credit against the income tax otherwise allowable with respect to compensation paid to an employee must be reduced by the differential wage payment credit allowed with respect to such employee.

The differential wage payment credit is part of the general business credit, and thus this credit is subject to the rules applicable to business credits. For example, an unused credit generally may be carried back to the taxable year that precedes an unused credit year or carried forward to each of the 20 taxable years following the unused credit year. Further, the credit is not allowable against a taxpayer's alternative minimum tax liability.

Rules similar to the rules in section 52(c), which bars the work opportunity tax credit for tax-exempt organizations other than certain farmer's cooperatives, apply to the differential wage payment credit. Additionally, rules similar to the rules in section 52(e), which limits the work opportunity tax credit allowable to regulated investment companies, real estate investment trusts, and certain cooperatives, apply to the differential wage payment credit.

The credit is available with respect to amounts paid after June 17, 2008,[382] and before January 1, 2012.

Reasons for Change[383]

Congress believes that it is still appropriate to encourage small employers to make differential wage payments to employees during any period that the employee is called to duty for a period of more than 30 days in the uniform services.

Explanation of Provision

The provision extends the availability of the credit for two years to amounts paid before January 1, 2014.

Effective Date

The provision applies to payments made after December 31, 2011.

9. Work opportunity tax credit (sec. 309 of the Act and secs. 51 and 52 of the Code)

Present Law

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service ren-

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[382] This date is the date of enactment of the Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110–245.

[383] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

dered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

(1) Families receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (e.g., a State employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified veteran

Prior to enactment of the "VOW to Hire Heroes Act of 2011" (the "VOW Act"),[384] there were two subcategories of qualified veterans to whom wages paid by an employer were eligible for the credit. Employers who hired veterans who were eligible to receive assistance under a supplemental nutritional assistance program were entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages paid to such individual.[385] Employers who hired veterans who were entitled to compensation for a service-connected disability were entitled to a maximum wage credit of 40 percent of $12,000 of qualified first-year wages paid to such individual.[386]

The VOW Act modified the work opportunity credit with respect to qualified veterans, by adding additional subcategories. There are now five subcategories of qualified veterans: (1) in the case of veterans who were eligible to receive assistance under a supplemental nutritional assistance program (for at least a three month period during the year prior to the hiring date) the employer is entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of $12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service

[384] Pub. L. No. 112–56 (Nov. 21, 2011).

[385] For these purposes, a qualified veteran must be certified by the designated local agency as a member of a family receiving assistance under a supplemental nutrition assistance program under the Food and Nutrition Act of 2008 for a period of at least three months part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a supplemental nutrition assistance program under the Food and Nutrition Act of 2008.

[386] The qualified veteran must be certified as entitled to compensation for a service-connected disability and (1) have a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States; or (2) have been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring. For these purposes, being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S. Code, which means having a disability rating of 10 percent or higher for service connected injuries.

connected disability, and who has been unemployed for an aggregate of at least six months during the one year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of $24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $14,000 of qualified first-year wages.

A veteran is 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 a qualified veteran 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.

(3) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law; and (2) having a hiring date within one year of release from prison or the date of conviction.

(4) Designated community resident

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community or a rural renewal community. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990–1994 and 1995–1999. Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community or a rural renewal community.

(5) Vocational rehabilitation referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a State plan approved under the Rehabilitation Act of 1973; (b) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code; or (c) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified summer youth employee

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15; (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date; (3) who has not been an employee of that employer before; and (4) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community. As with designated community residents, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues 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 will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified supplemental nutrition assistance program benefits recipient

A qualified supplemental nutrition assistance program benefits recipient is an individual at least age 18 but not yet age 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food and nutrition program under the Food and Nutrition Act of 2008 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food and nutrition assistance under section 6(o) of the Food and Nutrition Act of 2008, the six-month requirement is replaced with a requirement that the family has been receiving food and nutrition assistance for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food and nutrition assistance program under the Food and Nutrition Act of 2008.

(8) Qualified SSI recipient

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income ("SSI") benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-term family assistance recipient

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit)[387] if the individual is hired within two years after the date that the 18-month total is reached; or (3) a member of a family who is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within two years after the Federal or State time limits made the family ineligible for family assistance.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) 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. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

For calculation of the credit with respect to qualified veterans, see the description of "qualified veteran" above.

Certification rules

Generally, an individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a

[387] The welfare-to-work tax credit was consolidated into the work opportunity tax credit in the Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, for qualified individuals who begin to work for an employer after December 31, 2006.

member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

An otherwise qualified unemployed veteran is treated as certified by the designated local agency as having aggregate periods of unemployment (whichever is applicable under the qualified veterans rules described above) if such veteran is certified by such agency as being in receipt of unemployment compensation under a State or Federal law for such applicable periods. The Secretary of the Treasury is authorized to provide alternative methods of certification for unemployed veterans.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Qualified tax-exempt organizations employing qualified veterans

The credit is not available to qualified tax-exempt organizations other than those employing qualified veterans. The special rules, described below, were enacted in the VOW Act.

If a qualified tax-exempt organization employs a qualified veteran (as described above) a tax credit against the FICA taxes of the organization is allowed on the wages of the qualified veteran which are paid for the veteran's services in furtherance of the activities related to the function or purpose constituting the basis of the organization's exemption under section 501.

The credit available to such tax-exempt employer for qualified wages paid to a qualified veteran equals 26 percent (16.25 percent for employment of 400 hours or less) of qualified first-year wages. The amount of qualified first-year wages eligible for the credit is the same as those for non-tax-exempt employers (i.e., $6,000, $12,000, $14,000 or $24,000, depending on the category of qualified veteran).

A qualified tax-exempt organization means an employer that is described in section 501(c) and exempt from tax under section 501(a).

The Social Security Trust Funds are held harmless from the effects of this provision by a transfer from the Treasury General Fund.

Treatment of possessions

The VOW Act provided a reimbursement mechanism for the U.S. possessions (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the United States Virgin Islands). The Treasury Secretary is to pay to each mirror code possession (Guam, the Commonwealth of the Northern Mariana Islands, and the United States Virgin Islands) an amount equal to the loss to that possession as a result of the VOW Act changes to the qualified veterans rules. Similarly, the Treasury Secretary is to pay to each non-mirror Code possession (American Samoa and the Commonwealth of Puerto Rico) the amount that the Secretary estimates as being equal to the loss to that possession that would have occurred as a result of the VOW Act changes if a mirror code tax system had been in effect in that possession. The Secretary will make this payment to a non-mirror Code possession only if that possession establishes to the satisfaction of the Secretary that the possession has implemented (or, at the discretion of the Secretary, will implement) an income tax benefit that is substantially equivalent to the qualified veterans credit allowed under the VOW Act modifications.

An employer that is allowed a credit against U.S. tax under the VOW Act with respect to a qualified veteran must reduce the amount of the credit claimed by the amount of any credit (or, in the case of a non-mirror Code possession, another tax benefit) that the employer claims against its possession income tax.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

Generally, the work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2011. The work opportunity tax credit for employers of qualified veterans is not available for such individuals who begin work for an employer after December 31, 2012.

Reasons for Change [388]

Given the level of unemployment and general economic conditions, Congress believes that the credit should be extended.

Explanation of Provision

The credit is extended for all eligible categories through December 31, 2013.

[388] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Effective Date

The provision is effective for individuals who begin work for the employer after December 31, 2011 (in the case of certain qualified veterans after December 31, 2012).

10. Qualified zone academy bonds (sec. 310 of the Act and sec. 54E of the Code)

Present Law

Tax-exempt bonds

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. These can include tax-exempt bonds which finance public schools.[389] An issuer must file with the Internal Revenue Service certain information about the bonds issued in order for that bond issue to be tax-exempt.[390] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[391] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[392] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue "qualified zone academy bonds."[393] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2008, $1,400 million in 2009 and 2010, and $400 million in 2011. Each calendar years bond limitation is allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond),

[389] Sec. 103.
[390] Sec. 149(e).
[391] Sec. 103(a) and (b)(2).
[392] Sec. 148.
[393] See secs. 54E and 1397E.

and may be claimed against regular income tax and alternative minimum tax liability.

Qualified zone academy bonds are a type of qualified tax credit bond and subject to the general rules applicable to qualified tax credit bonds.[394] The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer.[395] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on the bond is 50 percent of the face value of the bond.

"Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) at least 100 percent of the available project proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Under section 6431 of the Code, an issuer of specified tax credit bonds, may elect to receive a payment in lieu of a credit being allowed to the holder of the bond. This provision is not available for qualified zone academy bond allocations from the 2011 national limitation or any carry forward of the 2011 allocation.[396]

Reasons for Change[397]

Congress believes that the past experience with the program warrants its extension.

[394] Sec. 54A.

[395] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

[396] Sec. 6431(f)(3)(A)(iii).

[397] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Explanation of Provision

The provision extends the qualified zone academy bond program for two years. The proposal authorizes issuance of up to $400 million of qualified zone academy bonds per year for 2012 and 2013.

The issuer election to receive a payment in lieu of providing a tax credit to the holder of the qualified zone academy bond is not available for bonds issued with the 2012 or 2013 national limitations.[398] The proposal has no effect on bonds issued with limitation carried forward from 2009 or 2010.

Effective Date

The provision applies to obligations issued after December 31, 2011.

11. 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (sec. 311 of the Act and sec. 168 of the Code)

Present Law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[399] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for cer-

[398] A technical correction to section 6431(f) of the Code may be needed so that the statute reflects this intent.
[399] Sec. 168.

tain qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2012. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[400] The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building. If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.

Qualified leasehold improvement property is recovered using the straight-line method and a half-year convention. Qualified leasehold improvement property placed in service after December 31, 2011 is subject to the general rules described above.

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2012. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building, if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.[401] Qualified restaurant property is recovered using the straight-line method and a half-year convention. Additionally, qualified restaurant property is not eligible for bonus depreciation.[402] Qualified restaurant property placed in service after December 31, 2011 is subject to the general rules described above.

Qualified retail improvement property

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property placed in service before January 1, 2012. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general pub-

[400] Sec. 168(e)(6).
[401] Sec. 168(e)(7).
[402] Property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property is eligible for bonus depreciation.

lic[403] and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.[404] Qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building. In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores, and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. Generally, it is intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.

Qualified retail improvement property is recovered using the straight-line method and a half-year convention. Additionally, qualified retail improvement property is not eligible for bonus depreciation.[405] Qualified retail improvement property placed in service after December 31, 2011 is subject to the general rules described above.

Reasons for Change[406]

Congress believes that taxpayers should not be required to recover the costs of certain leasehold improvements beyond the useful life of the investment. The 39-year recovery period for leasehold improvements for property placed in service after December 31, 2007, extends beyond the useful life of many such investments. Although lease terms differ, Congress believes that lease terms for commercial real estate also are typically shorter than the 39-year recovery period. In the interests of simplicity and administrability, a uniform period for recovery of leasehold improvements is desirable. Therefore, the provision extends the 15-year recovery period for leasehold improvements.

Congress also believes that unlike other commercial buildings, restaurant buildings generally are more specialized structures. Restaurants also experience considerably more traffic and remain open longer than most commercial properties. This daily use causes rapid deterioration of restaurant properties and forces restaurateurs to constantly repair and upgrade their facilities. As such, restaurant facilities generally have a shorter life span than

[403] Improvements to portions of a building not open to the general public (e.g., stock room in back of retail space) do not qualify under the provision.

[404] Sec. 168(e)(8).

[405] Property that satisfies the definition of both qualified leasehold improvement property and qualified retail property is eligible for bonus depreciation.

[406] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

other commercial establishments. The provision extends the 15-year recovery period for improvements made to restaurant buildings and continues to apply the 15-year recovery period to new restaurants, to more accurately reflect the true economic life of such properties.

Congress believes that taxpayers should not be required to recover the costs of certain improvements beyond the useful life of the investment. The 39-year recovery period for improvements to owner occupied (i.e., not leased) retail property extends beyond the useful life of many such investments. Additionally, Congress believes that retailers should not be treated differently based on whether the building in which they operate is owned or leased. As many small business retailers own the building in which they operate their business, Congress believes this provision will provide relief to small businesses. Therefore, the provision extends the 15-year recovery period for qualified retail improvements.

Explanation of Provision

The present law provisions for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property are extended for two years to apply to property placed in service on or before December 31, 2013.

Effective Date

The provision is effective for property placed in service after December 31, 2011.

12. Seven-year recovery period for motorsports entertainment complexes (sec. 312 of the Act and sec. 168 of the Code)

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[407] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month. Land improvements (such as roads and fences) are recovered over 15 years. An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years. Additionally, a motorsports entertainment complex placed in

[407] Sec. 168.

service on or before December 31, 2011 is assigned a recovery period of seven years.[408] For these purposes, a motorsports entertainment complex means a racing track facility which is permanently situated on land and which during the 36-month period following its placed-in-service date hosts a racing event.[409] The term motorsports entertainment complex also includes ancillary facilities, land improvements (e.g., parking lots, sidewalks, fences), support facilities (e.g., food and beverage retailing, souvenir vending), and appurtenances associated with such facilities (e.g., ticket booths, grandstands).

Reasons for Change[410]

Congress believes that extending the depreciation incentive will encourage economic development. Thus, the provision extends the seven-year recovery period for motorsports entertainment complex property.

Explanation of Provision

The provision extends the present-law seven-year recovery period for motorsports entertainment complexes for two years to apply to property placed in service before January 1, 2014.

Effective Date

The provision is effective for property placed in service after December 31, 2011.

13. Accelerated depreciation for business property on an Indian reservation (sec. 313 of the Act and sec. 168(j) of the Code)

Present Law

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j) are determined using the following recovery periods:

3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Nonresidential real property	22 years

"Qualified Indian reservation property" eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer;[411] and (4) is not property placed in service for pur-

[408] Sec. 168(e)(3)(C)(ii).
[409] Sec. 168(i)(15).
[410] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).
[411] For these purposes, related persons is defined in Sec. 465(b)(3)(C).

poses of conducting gaming activities.[412] Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).[413]

An "Indian reservation" means a reservation as defined in section 3(d) of the Indian Financing Act of 1974[414] or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).[415] For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for qualified Indian reservation property is available with respect to property placed in service before January 1, 2012.

Reasons for Change[416]

Congress believes that extending the depreciation incentive will encourage economic development within Indian reservations and expand employment opportunities on such reservations.

Explanation of Provision

The provision extends for two years the present-law accelerated MACRS recovery periods for qualified Indian reservation property to apply to property placed in service before January 1, 2014.

Effective Date

The provision is effective for property placed in service after December 31, 2011.

14. Enhanced charitable deduction for contributions of food inventory (sec. 314 of the Act and sec. 170 of the Code)

Present Law

Charitable contributions in general

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization.[417]

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property are

[412] Sec. 168(j)(4)(A).
[413] Sec. 168(j)(4)(C).
[414] Pub. L. No. 93–262.
[415] Pub. L. No. 95–608.
[416] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).
[417] Sec. 170.

deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

General rules regarding contributions of inventory

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less the fair market value of the inventory.

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[418] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[419] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer and must be contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.[420] In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, as amended, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.[421]

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[422]

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.[423]

Temporary rule expanding and modifying the enhanced deduction for contributions of food inventory

Under a special temporary provision, any taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to

[418] Sec. 170(e)(3).
[419] Sec. 170(b)(2).
[420] Sec. 170(e)(3)(A)(i)-(iii).
[421] Sec. 170(e)(3)(A)(iv).
[422] Treas. Reg. sec. 1.170A–4A(c)(3).
[423] Lucky Stores Inc. v. Commissioner, 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).

claim the enhanced deduction for donations of food inventory.[424] For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporations) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.[425]

Under the temporary provision, the enhanced deduction for food is available only for food that qualifies as "apparently wholesome food." Apparently wholesome food is defined as food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

The temporary provision does not apply to contributions made after December 31, 2011.

Reasons for Change[426]

Congress believes that charitable organizations benefit from charitable contributions of food inventory by non-C corporations and that the enhanced deduction is a useful incentive for the making of such contributions. Accordingly, Congress believes it is appropriate to extend the special rule for charitable contributions of food inventory for two years.

Explanation of Provision

The provision extends the expansion of, and modifications to, the enhanced deduction for charitable contributions of food inventory to contributions made before January 1, 2014.

Effective Date

The provision is effective for contributions made after December 31, 2011.

[424] Sec. 170(e)(3)(C).

[425] The 10 percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory by a taxpayer that is not a C corporation that exceed the 10 percent limitation but not the 50 percent limitation could not be carried forward.

[426] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

15. Increased expensing for small business depreciable assets (sec. 315 of the Act and sec. 179 of the Code)

Present Law

A taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation.[427] For taxable years beginning in 2012, the maximum amount a taxpayer may expense is $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000.[428] The $125,000 and $500,000 amounts are indexed for inflation occurring since 2006.[429] The indexed amounts for 2012 are $139,000 and $560,000. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2013 also is treated as qualifying property.

For taxable years beginning in 2010 and 2011, the maximum amount a taxpayer may expense is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000. For taxable years beginning in 2010 and 2011, qualifying property also includes certain real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).[430] Of the $500,000 expense amount available under section 179 for 2010 and 2011, the maximum amount available with respect to qualified real property is $250,000 for each taxable year.

For taxable years beginning in 2013 and thereafter, a taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year, subject to limitation. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property (not including off-the-shelf computer software) that is purchased for use in the active conduct of a trade or business.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations). How-

[427] Additional section 179 incentives have been provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)). In addition, section 179(e) provides for an enhanced section 179 deduction for qualified disaster assistance property.

[428] Sec. 179(b)(2).

[429] Sec. 179(b)(6).

[430] Sec. 179(f).

ever, amounts attributable to qualified real property that are disallowed under the trade or business income limitation may only be carried over to taxable years in which the definition of eligible section 179 property includes qualified real property.[431] Thus, if a taxpayer's section 179 deduction for 2010 with respect to qualified real property is limited by the taxpayer's active trade or business income, such disallowed amount may be carried over to 2011. Any such carryover amounts that are not used in 2011 are treated as property placed in service in 2011 for purposes of computing depreciation. That is, the unused carryover amount from 2010 is considered placed in service on the first day of the 2011 taxable year.[432]

No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[433] In general, any election or specification made with respect to any property may not be revoked except with the consent of the Commissioner. However, an election or specification under section 179 may be revoked by the taxpayer without consent of the Commissioner for taxable years beginning after 2002 and before 2013.[434]

Reasons for Change[435]

Congress believes that section 179 expensing provides two important benefits for small businesses. First, it lowers the cost of capital for tangible property used in a trade or business. With a lower cost of capital, Congress believes small businesses will invest in more equipment and employ more workers. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. In order to increase the value of these benefits and to increase the number of taxpayers eligible, the provision increases the amount allowed to be expensed under section 179 and increases the amount of the phase-out threshold.

Congress also believes that qualified real property (i.e., leasehold improvement property, restaurant property, and retail improvement property) should continue to be included in the section 179 expensing provision to encourage small businesses to invest in these types of real property. Further, Congress believes that purchased computer software should continue to be included in the section 179 expensing provision so that it is not disadvantaged relative to developed software. In addition, Congress believes that the process of making and revoking section 179 elections should con-

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[431] Section 179(f)(4) details the special rules that apply to disallowed amounts.

[432] For example, assume that during 2010, a company's only asset purchases are section 179-eligible equipment costing $100,000 and qualifying leasehold improvements costing $200,000. Assume the company has no other asset purchases during 2010, and has a taxable income limitation of $150,000. The maximum section 179 deduction the company can claim for 2010 is $150,000, which is allocated pro rata between the properties, such that the carryover to 2011 is allocated $100,000 to the qualified leasehold improvements and $50,000 to the equipment.

Assume further that in 2011, the company had no asset purchases and had taxable income of $-0-. The $100,000 carryover from 2010 attributable to qualified leasehold improvements is treated as placed in service as of the first day of the company's 2011 taxable year. The $50,000 carryover allocated to equipment is carried over to 2012 under section 179(b)(3)(B).

[433] Sec. 179(c)(1).

[434] Sec. 179(c)(2).

[435] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

tinue to be simpler and more efficient for taxpayers by eliminating the requirement of the consent of the Commissioner.

Explanation of Provision

The provision provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2012 and 2013, is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000.

In addition, the provision extends, for taxable years beginning in 2013, the treatment of off-the-shelf computer software as qualifying property. The provision also extends the treatment of qualified real property as eligible section 179 property for taxable years beginning in 2012 and 2013, including the limitation on carryovers and the maximum amount of $250,000 for each taxable year. The provision makes a technical drafting correction by clarifying that for the last taxable year beginning in 2013, the taxable income limitation[436] is computed without regard to any additional depreciation expense resulting from the application of the carryover limitation of section 179(f)(4). For taxable years beginning in 2013, the provision continues to permit a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

16. Election to expense mine safety equipment (sec. 316 of the Act and sec. 179E of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[437] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. Present law provides that the maximum amount a taxpayer may expense for taxable years beginning

[436] Sec. 179(b)(3).
[437] Sec. 168.

in 2012 is $125,000 of the cost of the qualifying property for the taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.[438] The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000.

A taxpayer may elect to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the taxable year in which the equipment is placed in service.[439] The deduction under section 179E is allowed for both regular and alternative minimum tax purposes, including adjusted current earnings. In computing earnings and profits, the amount deductible under section 179E is allowed as a deduction ratably over five taxable years beginning with the year the amount is deductible under section 179E.[440]

"Qualified advanced mine safety equipment property" means any advanced mine safety equipment property for use in any underground mine located in the United States the original use of which commences with the taxpayer and which is placed in service before January 1, 2012.[441]

Advanced mine safety equipment property means any of the following: (1) emergency communication technology or devices used to allow a miner to maintain constant communication with an individual who is not in the mine; (2) electronic identification and location devices that allow individuals not in the mine to track at all times the movements and location of miners working in or at the mine; (3) emergency oxygen-generating, self-rescue devices that provide oxygen for at least 90 minutes; (4) pre-positioned supplies of oxygen providing each miner on a shift the ability to survive for at least 48 hours; and (5) comprehensive atmospheric monitoring systems that monitor the levels of carbon monoxide, methane and oxygen that are present in all areas of the mine and that can detect smoke in the case of a fire in a mine.[442]

The portion of the cost of any property with respect to which an expensing election under section 179 is made may not be taken into account for purposes of the 50-percent deduction under section 179E.[443] In addition, a taxpayer making an election under section 179E must file with the Secretary a report containing information with respect to the operation of the mines of the taxpayer as required by the Secretary.[444]

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[438] The definition of qualifying property was temporarily (for 2010 and 2011) expanded to include up to $250,000 of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. See section 179(c).

[439] Sec. 179E(a).

[440] Sec. 312(k)(3).

[441] Secs. 179E(c) and (g).

[442] Sec. 179E(d).

[443] Sec. 179E(e).

[444] Sec. 179E(f).

Reasons for Change[445]

Congress believes that mine safety equipment is vital to ensuring a safe workplace for the nation's underground mine workforce. Therefore, Congress believes that this incentive for mine safety equipment property should be extended.

Explanation of Provision

The provision extends for two years (through December 31, 2013) the present-law placed in service date relating to expensing of mine safety equipment.

Effective Date

The provision applies to property placed in service after December 31, 2011.

17. Special expensing rules for certain film and television productions (sec. 317 of the Act and sec. 181 of the Code)

Present Law

The modified accelerated cost recovery system ("MACRS") does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197, which allows amortization for certain intangible property, does not apply to some intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost recovery of such property may be determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property. A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. Section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation.

Under section 181, taxpayers may elect[446] to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2012, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allow-

[445] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[446] See Temp. Treas. Reg. section 1.181–2T for rules on making an election under this section.

ances.[447] Taxpayers may elect to deduct up to $15 million of the aggregate cost of the film or television production under this section.[448] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[449]

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[450] The term "compensation" does not include participations and residuals (as defined in section 167(g)(7)(B)).[451] With respect to property which is one or more episodes in a television series, each episode is treated as a separate production and only the first 44 episodes qualify under the provision.[452] Qualified property does not include sexually explicit productions as defined by section 2257 of title 18 of the U.S. Code.[453]

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.[454]

Reasons for Change[455]

Congress believes that section 181 encourages domestic film production and that the provision should be extended. The issue of runaway production affects all productions, regardless of cost, and therefore Congress believes that it is appropriate to treat as an expense the first $15 million ($20 million in certain cases) of production costs of otherwise qualified films.

Explanation of Provision

The provision extends the present-law expensing provision for two years, to qualified film and television productions commencing prior to January 1, 2014.

Effective Date

The provision applies to qualified film and television productions commencing after December 31, 2011.

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[447] For this purpose, a production is treated as commencing on the first date of principal photography.
[448] Sec. 181(a)(2)(A).
[449] Sec. 181(a)(2)(B).
[450] Sec. 181(d)(3)(A).
[451] Sec. 181(d)(3)(B).
[452] Sec. 181(d)(2)(B).
[453] Sec. 181(d)(2)(C).
[454] Sec. 1245(a)(2)(C).
[455] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

18. Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sec. 318 of the Act and sec. 199 of the Code)

Present Law

General

Present law provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income for the taxable year. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[456] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[457] produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

The amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[458] Wages paid to bona fide residents of Puerto Rico generally are not included in the definition of wages for purposes of computing the wage limitation amount.[459]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Co-

[456] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[457] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

[458] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

[459] Section 3401(a)(8)(C) excludes wages paid to United States citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.

lumbia.[460] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations.[461] In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[462]

The special rules for Puerto Rico apply only with respect to the first six taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2012.

Reasons for Change[463]

Congress believes that, notwithstanding expiration of the Puerto Rico and possession tax credit and the Puerto Rico economic activity credit for taxable years beginning after 2005, the Code should promote economic activity in Puerto Rico. Consequently, Congress believes that it is appropriate to treat Puerto Rico as part of the United States for purposes of the domestic production activities deduction.

Explanation of Provision

The provision extends the special domestic production activities rules for Puerto Rico to apply for the first eight taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2014.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

19. Modification of tax treatment of certain payments to controlling exempt organizations (sec. 319 of the Act and sec. 512 of the Code)

Present Law

In general, organizations exempt from Federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[464] In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.[465]

Section 512(b)(13) provides special rules regarding income derived by an exempt organization from a controlled subsidiary. In

[460] Sec. 7701(a)(9).
[461] Sec. 199(d)(8)(A).
[462] Sec. 199(d)(8)(B).
[463] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).
[464] Sec. 511.
[465] Sec. 512(b).

general, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business taxable income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt). However, a special rule provides that, for payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of section 512(b)(13) applies only to the portion of payments received or accrued in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of section 482 (i.e., at arm's length).[466] In addition, the special rule imposes a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, "control" means ownership of more than 50 percent of the profits, capital, or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

The special rule does not apply to payments received or accrued after December 31, 2011.

Reasons for Change[467]

Congress believes it is desirable to extend the special rule for an additional two years.

Explanation of Provision

The provision extends the special rule for two years to payments received or accrued before January 1, 2014. Accordingly, under the provision, payments of rent, royalties, annuities, or interest income by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of section 482 (i.e., at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

[466] Sec. 512(b)(13)(E).

[467] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Effective Date

The provision is effective for payments received or accrued after December 31, 2011.

20. Treatment of certain dividends of regulated investment companies (sec. 320 of the Act and sec. 871(k) of the Code)

Present Law

In general

A regulated investment company ("RIC") is an entity that meets certain requirements (including a requirement that its income generally be derived from passive investments such as dividends and interest and a requirement that it distribute at least 90 percent of its income) and that elects to be taxed under a special tax regime. Unlike an ordinary corporation, an entity that is taxed as a RIC can deduct amounts paid to its shareholders as dividends. In this manner, tax on RIC income is generally not paid by the RIC but rather by its shareholders. Income of a RIC distributed to shareholders as dividends is generally treated as an ordinary income dividend by those shareholders, unless other special rules apply. Dividends received by foreign persons from a RIC are generally subject to gross-basis tax under sections 871(a) or 881, and the RIC payor of such dividends is obligated to withhold such tax under sections 1441 and 1442.

Under a temporary provision of prior law, a RIC that earned certain interest income that generally would not be subject to U.S. tax if earned by a foreign person directly could, to the extent of such net interest income, designate a dividend it paid as derived from such interest income for purposes of the treatment of a foreign RIC shareholder. A foreign person who is a shareholder in the RIC generally could treat such a dividend as exempt from gross-basis U.S. tax. Also, subject to certain requirements, the RIC was exempt from withholding the gross-basis tax on such dividends. Similar rules applied with respect to the designation of certain short-term capital gain dividends. However, these provisions relating to dividends with respect to interest income and short-term capital gain of the RIC have expired, and therefore do not apply to dividends with respect to any taxable year of a RIC beginning after December 31, 2011.[468]

Reasons for Change[469]

Congress believes it is desirable to extend the provision for an additional two years.

Explanation of Provision

The provision extends the rules exempting from gross basis tax and from withholding tax the interest-related dividends and short-

[468] Secs. 871(k), 881(e), 1441(c)(12), and 1441(a).

[469] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

term capital gain dividends received from a RIC, to dividends with respect to taxable years of a RIC beginning before January 1, 2014.

Effective Date

The provision applies to dividends paid with respect to any taxable year of the RIC beginning after December 31, 2011.

21. RIC qualified investment entity treatment under FIRPTA (sec. 321 of the Act and secs. 897 and 1445 of the Code)

Present Law

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, although a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or active business requirements are met, a foreign person who sells a U.S. real property interest ("USRPI") is subject to tax at the same rates as a U.S. person, under the Foreign Investment in Real Property Tax Act ("FIRPTA") provisions codified in section 897 of the Code. Withholding tax is also imposed under section 1445.

A USRPI includes stock or a beneficial interest in any domestic corporation unless such corporation has not been a U.S. real property holding corporation (as defined) during the testing period. A USRPI does not include an interest in a domestically controlled "qualified investment entity." A distribution from a "qualified investment entity" that is attributable to the sale of a USRPI is also subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United States and the recipient foreign corporation or nonresident alien individual did not hold more than five percent of that class of stock or beneficial interest within the one-year period ending on the date of distribution.[470] Special rules apply to situations involving tiers of qualified investment entities.

The term "qualified investment entity" includes a real estate investment trust ("REIT") and also includes a regulated investment company ("RIC") that meets certain requirements, although the inclusion of a RIC in that definition does not apply for certain purposes after December 31, 2011.[471]

Reasons for Change[472]

Congress believes it is desirable to extend the provision for an additional two years.

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[470] Sections 857(b)(3)(F), 852(b)(3)(E), and 871(k)(2)(E) require dividend treatment, rather than capital gain treatment, for certain distributions to which FIRPTA does not apply by reason of this exception. See also section 881(e)(2).

[471] Section 897(h).

[472] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Explanation of Provision

The provision extends the inclusion of a RIC within the definition of a "qualified investment entity" under section 897 through December 31, 2013, for those situations in which that inclusion would otherwise have expired after December 31, 2011.

Effective Date

The provision is generally effective on January 1, 2012.

The provision does not apply with respect to the withholding requirement under section 1445 for any payment made before the date of enactment, but a RIC that withheld and remitted tax under section 1445 on distributions made after December 31, 2011 and before the date of enactment is not liable to the distributee with respect to such withheld and remitted amounts.

22. Exceptions for active financing income (sec. 322 of the Act and secs. 953 and 954 of the Code)

Present Law

Under the subpart F rules,[473] 10-percent-or-greater U.S. shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (*i.e.,* income derived from services performed for or on behalf of a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and real estate mortgage investment conduits ("REMICs"); (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insur-

[473] Secs. 951–964.

ance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income.[474]

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in

[474] Prop. Treas. Reg. sec. 1.953–1(a).

a country other than the United States, provided that the requirements for these exceptions are met. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Reasons for Change [475]

Congress believes that it is appropriate to extend the temporary provisions for an additional two years to provide certainty and to allow for business planning.

Explanation of Provision

The provision extends for two years (for taxable years beginning before January 1, 2014) the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2011, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

23. Look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules (sec. 323 of the Act and sec. 954(c)(6) of the Code)

Present Law

In general

The rules of subpart F [476] require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation ("CFC") to include certain income of the CFC (referred to as "subpart F income") on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal hold-

[475] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).
[476] Secs. 951–964.

ing company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor. In addition, subpart F income of a CFC does not include any item of income from sources within the United States that is effectively connected with the conduct by such CFC of a trade or business within the United States ("ECI") unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

The "look-thru rule"

Under the "look-thru rule" (sec. 954(c)(6)), dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the payor that is neither subpart F income nor treated as ECI. For this purpose, a related CFC is a CFC that controls or is controlled by the other CFC, or a CFC that is controlled by the same person or persons that control the other CFC. Ownership of more than 50 percent of the CFC's stock (by vote or value) constitutes control for these purposes.

The Secretary is authorized to prescribe regulations that are necessary or appropriate to carry out the look-thru rule, including such regulations as are necessary or appropriate to prevent the abuse of the purposes of such rule.

The look-thru rule is effective for taxable years of foreign corporations beginning before January 1, 2012, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Reasons for Change[477]

Congress believes that it is appropriate to extend the look-through provision for an additional two years[478] in order to assist the competitiveness of U.S. companies with overseas operations.

[477] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[478] The provision was originally enacted in the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109–222), for taxable years beginning before January 1, 2009, and extended for one year in the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Div. C of Pub. L. No. 110–343). It was most recently extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111–312) through December 31, 2011.

Explanation of Provision

The provision extends for two years the application of the look-thru rule, to taxable years of foreign corporations ending before January 1, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2011, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

24. Exclusion of 100 percent of gain on certain small business stock (sec. 324 of the Act and sec. 1202 of the Code)

Present Law

In general

A taxpayer other than a corporation may exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years.[479] The amount of gain eligible for the exclusion by an eligible taxpayer with respect to the stock of any qualifying domestic C corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) $10 million (reduced by the amount of gain eligible for exclusion in prior years). To qualify as a qualified small business, when the stock is issued, the aggregate gross assets (i.e., cash plus aggregate adjusted basis of other property) held by the domestic C corporation may not exceed $50 million. The corporation also must meet certain active trade or business requirements.

The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax.[480] A percentage of the excluded gain is an alternative minimum tax preference;[481] the portion of the gain includible in alternative minimum taxable income is taxed at a maximum rate of 28 percent under the alternative minimum tax.

Gain from the sale of qualified small business stock generally is taxed at effective rates of 14 percent under the regular tax[482] and (i) 14.98 percent under the alternative minimum tax for dispositions in a taxable year beginning before January 1, 2013; (ii) 19.88 percent under the alternative minimum tax for dispositions in a taxable year beginning after December 31, 2012, in the case of stock acquired before January 1, 2001; and (iii) 17.92 percent under the alternative minimum tax for dispositions in a taxable year be-

[479] Sec. 1202.
[480] Sec. 1(h).
[481] Sec. 57(a)(7). In the case of qualified small business stock, the percentage of gain excluded from gross income which is an alternative minimum tax preference is (i) seven percent in the case of stock disposed of in a taxable year beginning before 2013; (ii) 42 percent in the case of stock acquired before January 1, 2001, and disposed of in a taxable year beginning after 2012; and (iii) 28 percent in the case of stock acquired after December 31, 2000, and disposed of in a taxable year beginning after 2012.
[482] The 50 percent of gain included in taxable income is taxed at a maximum rate of 28 percent.

ginning after December 31, 2012, in the case of stock acquired after December 31, 2000.[483]

Special rules for certain qualified small business stock acquired in 2009, 2010, and 2011

For qualified small business stock acquired after February 17, 2009, and before September 28, 2010, the percentage exclusion is increased to 75 percent.

As a result of the increased exclusion, gain from the sale of qualified small business stock to which the provision applies is taxed at maximum effective rates of seven percent under the regular tax[484] and 12.88 percent under the AMT.[485]

For qualified small business stock acquired after September 27, 2010, and before January 1, 2012, the percentage exclusion is increased to 100 percent and the minimum tax preference does not apply.

Rollover of gain

A taxpayer other than a corporation may elect to rollover gain from the sale of qualified small business stock held more than six months where other qualified small business stock is purchased during the 60-day period beginning on the date of sale.[486] The holding period for the replacement stock includes the period the original stock was held.[487]

Reasons for Change[488]

Congress believes that extending the increased exclusion and the elimination of the minimum tax preference for small business stock gain will encourage and reward investment in qualified small business stock.

Explanation of Provision

The provision extends the 100-percent exclusion and the exception from minimum tax preference treatment for two years (for stock acquired before January 1, 2014).[489]

The provision clarifies that in the case of any qualified small business stock acquired (determined without regard to the tacked-holding period) after February 17, 2009, and before January 1,

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[483] The amount of gain included in alternative minimum tax is taxed at a maximum rate of 28 percent. The amount so included is the sum of (i) 50 percent (the percentage included in taxable income) of the total gain and (ii) the applicable preference percentage of the one-half gain that is excluded from taxable income.

[484] The 25 percent of gain included in taxable income is taxed at a maximum rate of 28 percent.

[485] The 46 percent of gain included in AMTI is taxed at a maximum rate of 28 percent. Forty-six percent is the sum of 25 percent (the percentage of total gain included in taxable income) plus 21 percent (the percentage of total gain which is an alternative minimum tax preference).

[486] Sec. 1045.

[487] Sec. 1223(13). Under present law, it is unclear whether the tacked-holding-period applies for purposes of determining when the replacement stock was acquired for purposes of determining the exclusion percentage. One commentator has suggested "it appears that 1223(13)'s tacked-holding-period should apply for this latter purpose [i.e., determining the date the replacement stock was acquired] as well." Ginsburg, Levin, and Rocap, Mergers, Acquisitions, and Buyouts, p. 2–399 (Feb. 2012).

[488] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[489] Section 102 of the Act makes permanent the seven-percent minimum tax preference amount for qualified small business stock acquired before September 28, 2010.

2014, the date of acquisition for purposes of determining the exclusion percentage is the date the holding period for the stock begins.[490] Thus, for example, if an individual (i) acquires qualified small business stock at its original issue for $1 million on July 1, 2006, (ii) sells the stock on March 1, 2012, for $2 million in a transaction in which gain is not recognized by reason of section 1045, (iii) acquires qualified replacement stock at its original issue on March 15, 2012, for $2 million, and (iv) sells the replacement stock for $3 million, 50 percent (and not 100 percent) of the $2 million gain on the sale of the replacement stock is excluded from gross income.[491]

Effective Date

The provision is generally effective for stock acquired after December 31, 2011.

The clarification applies to stock acquired after February 17, 2009.

25. Basis adjustment to stock of S corporations making charitable contributions of property (sec. 325 of the Act and sec. 1367 of the Code)

Present Law

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.[492] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[493]

In the case of charitable contributions made in taxable years beginning before January 1, 2012, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For contributions made in taxable years beginning after December 31, 2011, the amount of the reduction is the shareholder's pro rata share of the fair market value of the contributed property.

Reasons for Change[494]

Congress believes that the treatment of charitable contributions of property by S corporations that applied to charitable contributions made in certain taxable years beginning before January 1, 2012, is appropriate and should be extended.

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[490] The provision is not intended to change the acquisition date determined under section 1202(i)(1)(A) for certain stock exchanged for property.

[491] This example assumes all the requirements of section 1202 are met with respect to the original stock and the replacement stock.

[492] Sec. 1366(a)(1)(A).

[493] Sec. 1367(a)(2)(B).

[494] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Explanation of Provision

The provision extends the rule relating to the basis reduction on account of charitable contributions of property for two years to contributions made in taxable years beginning before January 1, 2014.

Effective Date

The provision applies to charitable contributions made in taxable years beginning after December 31, 2011.

26. Reduction in recognition period for S corporation built-in gains tax (sec. 326 of the Act and sec. 1374 of the Code)

Present Law

In general

A "small business corporation" (as defined in section 1361(b)) may elect to be treated as an S corporation. Unlike C corporations, S corporations generally pay no corporate-level tax. Instead, items of income and loss of an S corporation pass through to its shareholders. Each shareholder takes into account separately its share of these items on its own income tax return.[495]

Under section 1374, a corporate level built-in gains tax, at the highest marginal rate applicable to corporations (currently 35 percent), is imposed on an S corporation's net recognized built-in gain[496] that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period, i.e., the 10-year period beginning with the first day of the first taxable year for which the S election is in effect.[497] If the taxable income of the S corporation is less than the amount of net recognized built-in gain in the year such built-in gain is recognized (for example, because of post-conversion losses), no tax under section 1374 is imposed on the excess of such built-in gain over taxable income for that year. However the untaxed excess of net recognized built-in gain over taxable income for that year is treated as recognized built-in gain in the succeeding taxable year.[498] Treasury regulations provide that if a corporation sells an asset before or during the recognition period and reports the income from the sale using the installment method under section 453 during or after the recognition period, that income is subject to tax under section 1374.[499]

The built-in gain tax also applies to net recognized built-in gain attributable to any asset received by an S corporation from a C corporation in a transaction in which the S corporation's basis in the asset is determined (in whole or in part) by reference to the basis

[495] Sec. 1366.

[496] Certain built-in income items are treated as recognized built-in gain for this purpose. Sec. 1374(d)(5).

[497] Sec. 1374(d)(7)(A). The 10-year period refers to ten calendar years from the first day of the first taxable year for which the corporation was an S corporation. Treas. Reg. sec. 1.1374–1(d). A regulated investment company (RIC) or a real estate investment trust (REIT) that was formerly a C corporation (or that acquired assets from a C corporation) generally is subject to the rules of section 1374 as if the RIC or REIT were an S corporation, unless the relevant C corporation elects "deemed sale" treatment. Treas. Reg. secs. 1.337(d)–7(b)(1) and (c)(1).

[498] Sec. 1374(d)(2).

[499] Treas. Reg. sec. 1.1374–4(h).

of such asset (or other property) in the hands of the C corporation.[500] In the case of such a transaction, the recognition period for any asset transferred by the C corporation starts on the date the asset was acquired by the S corporation in lieu of the beginning of the first taxable year for which the corporation was an S corporation.[501]

The amount of the built-in gain tax under section 1374 is treated as a loss by each of the S corporation shareholders in computing its own income tax.[502]

Special rules for 2009, 2010, and 2011

For any taxable year beginning in 2009 and 2010, no tax was imposed on the net recognized built-in gain of an S corporation under section 1374 if the seventh taxable year in the corporation's recognition period preceded such taxable year.[503] Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under section 1374 if the seventh taxable year that the S corporation election was in effect preceded the taxable year beginning in 2009 or 2010.

For any taxable year beginning in 2011, no tax was imposed on the net recognized built-in gain of an S corporation under section 1374 if the fifth year in the corporation's recognition period preceded such taxable year.[504] Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under section 1374 if the S corporation election was in effect for five years preceding the taxable year beginning in 2011.

Reasons for Change[505]

Congress believes it is desirable to continue to provide a shortened period for purposes of the built-in gain tax, for an additional two years. The Act also makes technical changes to insure the provision operates as intended.

Explanation of Provision

For taxable years beginning in 2012 and 2013, the provision applies the term "recognition period" in section 1374, for purposes of determining the net recognized built-in gain, by substituting a five-year period[506] for the otherwise applicable 10-year period. Thus, for such taxable years, the recognition period is the five-year period beginning with the first day of the first taxable year for which the corporation was an S corporation (or beginning with the date of acquisition of assets if the rules applicable to assets acquired from a C corporation apply). If an S corporation with assets subject to section 1374 disposes of such assets in a taxable year beginning in

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[500] Sec. 1374(d)(8).
[501] Sec. 1374(d)(8)(B).
[502] Sec. 1366(f)(2). Shareholders continue to take into account all items of gain and loss under section 1366.
[503] Sec. 1374(d)(7)(B).
[504] Sec. 1374(d)(7)(C).
[505] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).
[506] The five-year period refers to five calendar years from the first day of the first taxable year for which the corporation was an S corporation.

2012 or 2013 and the disposition occurs more than five years after the first day of the relevant recognition period, gain or loss on the disposition will not be taken into account in determining the net recognized built-in gain.

A technical amendment provides that the rule requiring the excess of net recognized built-in gain over taxable income for a taxable year to be carried over and treated as recognized built-in gain in the succeeding taxable year applies only to gain recognized within the recognition period. Thus, for example, built-in gain recognized in a taxable year beginning in 2013, from a disposition in that year that occurs beyond the end of the temporary 5-year recognition period, will not be carried forward under the income limitation rule and treated as recognized built-in gain in the taxable year beginning in 2014 (after the temporary provision has expired and the recognition period is again 10 years).

If an S corporation subject to section 1374 sells a built-in gain asset and reports the income from the sale using the installment method under section 453, the treatment of all payments received will be governed by the provisions of section 1374(d)(7) applicable to the taxable year in which the sale was made. Thus, for example, if an S corporation sold a built-in gain asset in 2008 in a sale occurring on or before the recognition period in effect at that time, and reported the gain using the installment method under section 453, gain recognized under that method in 2012 or 2013 (including, for example, any gain under section 453B from a disposition of the installment obligation in those years)[507] is subject to tax under section 1374. On the other hand, if a corporation sold an asset in a taxable year beginning in 2012 or 2013, and the sale occurred beyond the end of the then-effective 5-year recognition period (but not beyond the end of the otherwise applicable 10-year recognition period), then gain reported using the installment method under section 453 in a taxable year beginning in 2014 (after the temporary provision expires) is not subject to tax under section 1374, because the sale was made after the end of the recognition period applicable to that sale. As a third example, if an S corporation sold an asset in a taxable year beginning in 2011, and no tax would have been imposed on the net recognized built-in gain from the sale under section 1374(d)(7)(B)(ii) because the fifth taxable year in the recognition period preceded such taxable year, then gain from such sale reported using the installment method under section 453 in a taxable year beginning in 2014 is not subject to tax under section 1374.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

[507] Section 453B requires gain or loss to be recognized on disposition of an installment obligation and treated as gain or loss resulting from the sale or exchange of the property in respect of which the installment obligation was received.

27. Empowerment zone tax incentives (sec. 327 of the Act and secs. 1202 and 1391 of the Code)

Present Law

The Omnibus Budget Reconciliation Act of 1993 ("OBRA 93")[508] authorized the designation of nine empowerment zones ("Round I empowerment zones") to provide tax incentives for businesses to locate within certain targeted areas[509] designated by the Secretaries of the Department of Housing and Urban Development ("HUD") and the U.S Department of Agriculture ("USDA"). The Taxpayer Relief Act of 1997[510] authorized the designation of two additional Round I urban empowerment zones, and 20 additional empowerment zones ("Round II empowerment zones"). The Community Renewal Tax Relief Act of 2000 ("2000 Community Renewal Act")[511] authorized a total of ten new empowerment zones ("Round III empowerment zones"), bringing the total number of authorized empowerment zones to 40.[512] In addition, the 2000 Community Renewal Act conformed the tax incentives that are available to businesses in the Round I, Round II, and Round III empowerment zones, and extended the empowerment zone incentives through December 31, 2009.[513] The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the empowerment zone incentives through December 31, 2011.[514]

The tax incentives available within the designated empowerment zones include a Federal income tax credit for employers who hire qualifying employees, accelerated depreciation deductions on qualifying equipment, tax-exempt bond financing, deferral of capital gains tax on sale of qualified assets sold and replaced, and partial exclusion of capital gains tax on certain sales of qualified small business stock.

The following is a description of the tax incentives.

Wage credit

A 20-percent wage credit is available to employers for the first $15,000 of qualified wages paid to each employee (i.e., a maximum credit of $3,000 with respect to each qualified employee) who (1) is

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[508] Pub. L. No. 103–66.

[509] The targeted areas are those that have pervasive poverty, high unemployment, and general economic distress, and that satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations.

[510] Pub. L. No. 105–34.

[511] Pub. L. No. 106–554.

[512] The urban part of the program is administered by the HUD and the rural part of the program is administered by the USDA. The eight Round I urban empowerment zones are Atlanta, GA; Baltimore, MD, Chicago, IL; Cleveland, OH; Detroit, MI; Los Angeles, CA; New York, NY; and Philadelphia, PA/Camden, NJ. Atlanta relinquished its empowerment zone designation in Round III. The three Round I rural empowerment zones are Kentucky Highlands, KY; Mid-Delta, MI; and Rio Grande Valley, TX. The 15 Round II urban empowerment zones are Boston, MA; Cincinnati, OH; Columbia, SC; Columbus, OH; Cumberland County, NJ; El Paso, TX; Gary/Hammond/East Chicago, IN; Ironton, OH/Huntington, WV; Knoxville, TN; Miami/Dade County, FL; Minneapolis, MN; New Haven, CT; Norfolk/Portsmouth, VA; Santa Ana, CA; and St. Louis, Missouri/East St. Louis, IL. The five Round II rural empowerment zones are Desert Communities, CA; Griggs-Steele, ND; Oglala Sioux Tribe, SD; Southernmost Illinois Delta, IL; and Southwest Georgia United, GA. The eight Round III urban empowerment zones are Fresno, CA; Jacksonville, FL; Oklahoma City, OK; Pulaski County, AR; San Antonio, TX; Syracuse, NY; Tucson, AZ; and Yonkers, NY. The two Round III rural empowerment zones are Aroostook County, ME; and Futuro, TX.

[513] If an empowerment zone designation were terminated prior to December 31, 2009, the tax incentives would cease to be available as of the termination date.

[514] Pub. L. No. 111–312.

a resident of the empowerment zone, and (2) performs substantially all employment services within the empowerment zone in a trade or business of the employer.[515]

The wage credit rate applies to qualifying wages paid before January 1, 2012. Wages paid to a qualified employee who earns more than $15,000 are eligible for the wage credit (although only the first $15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the empowerment zone may claim the wage credit, regardless of whether the employer meets the definition of an "enterprise zone business."[516]

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[517] Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under section 51 or the welfare-to-work credit under section 51A.[518] In addition, the $15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.[519] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[520]

Increased section 179 expensing limitation

An enterprise zone business is allowed an additional $35,000 of section 179 expensing (for a total of up to $535,000 in 2010 and 2011)[521] for qualified zone property placed in service before January 1, 2012.[522] The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds $2,000,000.[523] The term "qualified zone property" is defined as depreciable tangible property (including buildings) provided that (i) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (ii) the original use of the property in an empowerment zone commences with the taxpayer, and (iii) substantially all of the use of the property is in an empowerment zone in the active conduct of a trade or business by the taxpayer. Special rules are provided in the case of property that is substantially renovated by the taxpayer.

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[515] Sec. 1396. The $15,000 limit is annual, not cumulative such that the limit is the first $15,000 of wages paid in a calendar year which ends with or within the taxable year.

[516] Secs. 1397C(b) and 1397C(c). However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B), including a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, or liquor store, or certain farming activities. In addition, wages are not eligible for the wage credit if paid to: (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

[517] Sec. 280C(a).

[518] Secs. 1396(c)(3)(A) and 51A(d)(2).

[519] Secs. 1396(c)(3)(B) and 51A(d)(2).

[520] Sec. 38(c)(2).

[521] The Small Business Jobs Act of 2010, Pub. L. No. 111–240, sec. 2021.

[522] Secs. 1397A, 1397D.

[523] Sec. 1397A(a)(2), 179(b)(2). For 2012 the limit is $500,000. For taxable years beginning after 2012, the limit is $200,000.

An enterprise zone business means any qualified business entity and any qualified proprietorship. A qualified business entity means, any corporation or partnership if for such year: (1) every trade or business of such entity is the active conduct of a qualified business within an empowerment zone; (2) at least 50 percent of the total gross income of such entity is derived from the active conduct of such business; (3) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within an empowerment zone; (4) a substantial portion of the intangible property of such entity is used in the active conduct of any such business; (5) a substantial portion of the services performed for such entity by its employees are performed in an empowerment zone; (6) at least 35 percent of its employees are residents of an empowerment zone; (7) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (8) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property.[524]

A qualified proprietorship is any qualified business carried on by an individual as a proprietorship if for such year: (1) at least 50 percent of the total gross income of such individual from such business is derived from the active conduct of such business in an empowerment zone; (2) a substantial portion of the use of the tangible property of such individual in such business (whether owned or leased) is within an empowerment zone; (3) a substantial portion of the intangible property of such business is used in the active conduct of such business; (4) a substantial portion of the services performed for such individual in such business by employees of such business are performed in an empowerment zone; (5) at least 35 percent of such employees are residents of an empowerment zone; (6) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (7) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to nonqualified financial property.[525]

A qualified business is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license or any business prohibited in connection with the employment credit.[526] In addition, the leasing of real property that is located within the empowerment zone is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property

[524] Sec. 1397C(b).
[525] Sec. 1397C(c).
[526] Sec. 1397C(d). Excluded businesses include any private or commercial golf course, country club, massage parlor, hot tub facility, sun tan facility, racetrack, or other facility used for gambling or any store the principal business of which is the sale of alcoholic beverages for off-premises consumption. Sec. 144(c)(6).

is not a qualified business unless at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

Expanded tax-exempt financing for certain zone facilities

States or local governments can issue enterprise zone facility bonds to raise funds to provide an enterprise zone business with qualified zone property.[527] These bonds can be used in areas designated enterprise communities as well as areas designated empowerment zones. To qualify, 95 percent (or more) of the net proceeds from the bond issue must be used to finance: (1) qualified zone property whose principal user is an enterprise zone business, and (2) certain land functionally related and subordinate to such property.

The term enterprise zone business is the same as that used for purposes of the increased section 179 deduction limitation (discussed above) with certain modifications for start-up businesses. First, a business will be treated as an enterprise zone business during a start-up period if (1) at the beginning of the period, it is reasonable to expect the business to be an enterprise zone business by the end of the start-up period, and (2) the business makes bona fide efforts to be an enterprise zone business. The start-up period is the period that ends with the start of the first tax year beginning more than two years after the later of (1) the issue date of the bond issue financing the qualified zone property, and (2) the date this property is first placed in service (or, if earlier, the date that is three years after the issue date).[528]

Second, a business that qualifies as an enterprise zone business at the end of the start-up period must continue to qualify during a testing period that ends three tax years after the start-up period ends. After the three-year testing period, a business will continue to be treated as an enterprise zone business as long as 35 percent of its employees are residents of an empowerment zone or enterprise community.

The face amount of the bonds may not exceed $60 million for an empowerment zone in a rural area, $130 million for an empowerment zone in an urban area with zone population of less than 100,000, and $230 million for an empowerment zone in an urban area with zone population of at least 100,000.

Elective roll over of capital gain from the sale or exchange of any qualified empowerment zone asset

Taxpayers can elect to defer recognition of gain on the sale of a qualified empowerment zone asset[529] held for more than one year

[527] Sec. 1394.
[528] Sec. 1394(b)(3).
[529] The term "qualified empowerment zone asset" means any property which would be a qualified community asset (as defined in section 1400F, relating to certain tax benefits for renewal communities) if in section 1400F: (i) references to empowerment zones were substituted for references to renewal communities, (ii) references to enterprise zone businesses (as defined in section 1397C) were substituted for references to renewal community businesses, and (iii) the date of the enactment of this paragraph were substituted for "December 31, 2001" each place it appears. Sec. 1397B(b)(1)(A).

A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock purchased for cash in an enterprise zone business), (2) a qualified community partnership interest (meaning a partnership interest acquired for cash in an enterprise zone business), and (3) qualified community business property (meaning tangible property originally used in an enand replaced within 60 days by another qualified empowerment zone asset in the same zone.[530] The deferral is accomplished by reducing the basis of the replacement asset by the amount of the gain recognized on the sale of the asset.

Partial exclusion of capital gains on certain small business stock

Generally, individuals may exclude a percentage of gain from the sale of certain small business stock acquired at original issue and held at least five years.[531] For stock acquired prior to February 18, 2009, or after December 31, 2011, the percentage is generally 50 percent, except that for empowerment zone stock the percentage is 60 percent. For stock acquired after February 17, 2009, and before January 1, 2012, a higher percentage applies to all small business stock with no additional percentage for empowerment zone stock.[532]

Other tax incentives

Other incentives not specific to empowerment zones but beneficial to these areas include the work opportunity tax credit for employers based on the first year of employment of certain targeted groups, including empowerment zone residents (up to $2,400 per employee), and qualified zone academy bonds for certain public schools located in an empowerment zone, or expected (as of the date of bond issuance) to have at least 35 percent of its students receiving free or reduced lunches.

Reasons for Change[533]

Congress believes that it continues to be important to provide tax incentives to individuals and businesses in empowerment zones and that it is appropriate to extend such incentives for an additional two years.

Explanation of Provision

The provision extends for two years, through December 31, 2013, the period for which the designation of an empowerment zone is in effect, thus extending for two years the empowerment zone tax incentives, including the wage credit, increased section 179 expensing for qualifying equipment, tax-exempt bond financing, and deferral of capital gains tax on sale of qualified assets replaced with other qualified assets.[534] In the case of a designation of an empowerment zone the nomination for which included a termination date which

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terprise zone business by the taxpayer) that is purchased or substantially improved after the date of the enactment of this paragraph.

For the definition of "enterprise zone business," see text accompanying *supra* note 490. For the definition of "qualified business," see text accompanying *supra* note 492.

[530] Sec. 1397B.

[531] Sec. 1202.

[532] Section 324 of the Act extends the higher percentage for two years (for stock acquired before January 1, 2014). For a more detailed description of the present law exclusion, see the explanation in this report to that section of the Act.

[533] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[534] A technical correction may be necessary to clarify that the elective rollover provision applies to qualified empowerment zone assets acquired after December 21, 2000 and before January 1, 2014.

is December 31, 2011, termination shall not apply with respect to such designation if the entity which made such nomination amends the nomination to provide for a new termination date in such manner as the Secretary may provide.

The provision extends for two years, through December 31, 2018, the period for which the percentage exclusion for qualified small business stock (of a corporation which is a qualified business entity) acquired on or before February 17, 2009 is 60 percent. Gain attributable to periods after December 31, 2018 for qualified small business stock acquired on or before February 17, 2009 or after December 31, 2013 is subject to the general rule which provides for a percentage exclusion of 50 percent.

Effective Date

The provision relating to the designation of an empowerment zone and the provision relating to the exclusion of gain from the sale or exchange of qualified small business stock held for more than five years applies to periods after December 31, 2011.

28. New York Liberty Zone tax-exempt bond financing (sec. 328 of the Act and sec. 1400L of the Code)

Present Law

An aggregate of $8 billion in tax-exempt private activity bonds is authorized for the purpose of financing the construction and repair of infrastructure in New York City ("Liberty Zone bonds"). The bonds must be issued before January 1, 2012.

Reasons for Change [535]

Congress believes that one additional extension will enable these bonds to be issued.

Explanation of Provision

The provision extends authority to issue Liberty Zone bonds for two years (through December 31, 2013).

Effective Date

The provision is effective for bonds issued after December 31, 2011.

29. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands (sec. 329 of the Act and sec. 7652(f) of the Code)

Present Law

A $13.50 per proof gallon [536] excise tax is imposed on distilled spirits produced in or imported into the United States.[537] The excise tax does not apply to distilled spirits that are exported from

[535] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[536] A proof gallon is a liquid gallon consisting of 50 percent alcohol. See sec. 5002(a)(10) and (11).

[537] Sec. 5001(a)(1).

the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).[538]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[539] The amount of the cover over is limited under Code section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon before January 1, 2012).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[540] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[541] All of the amounts covered over are subject to the limitation.

Reasons for Change[542]

Congress believes that the needs of Puerto Rico and the Virgin Islands justify the extension of the cover over amount of $13.25 per gallon through December 31, 2013.

Explanation of Provision

The provision suspends for two years the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover over limitation of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2011 and before January 1, 2014. After December 31, 2013, the cover over amount reverts to $10.50 per proof gallon.

Effective Date

The provision is effective for articles brought into the United States after December 31, 2011.

30. Extension and Modification of American Samoa Economic Development Credit (sec. 330 of the Act and sec. 119 of Pub. L. No. 109–432)

Present Law

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006

[538] Secs. 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c).
[539] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).
[540] Sec. 7652(e)(2).
[541] Secs. 7652(a)(3), (b)(3), and (e)(1).
[542] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

is allowed a credit based on the corporation's economic activity-based limitation with respect to American Samoa. The credit is not part of the Code but is computed based on the rules of sections 30A and 936. The credit is allowed for the first six taxable years of a corporation that begin after December 31, 2005, and before January 1, 2012.

A corporation was an existing credit claimant with respect to a American Samoa if (1) the corporation was engaged in the active conduct of a trade or business within American Samoa on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit [543] in an election in effect for its taxable year that included October 13, 1995.[544] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

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[543] For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b), 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936.

Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit generally expired for taxable years beginning after December 31, 2005.

[544] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

The credit applies to the first six taxable years of a taxpayer which begin after December 31, 2005, and before January 1, 2012.

Reasons for Change[545]

Congress believes that, notwithstanding expiration of the Puerto Rico and possession tax credit for taxable years beginning after 2005, the U.S. Federal tax law should encourage economic activity in American Samoa. Congress believes that a tax incentive for economic activity in American Samoa should be available to some domestic corporations that did not claim the possession tax credit but that a domestic corporation, whether or not an existing credit claimant, should be eligible for the incentive only if it has manufacturing income in American Samoa. Consequently, Congress believes it is appropriate to extend and modify (in the manner described below) the American Samoa economic development credit.

Explanation of Provision

The provision extends the credit to apply to the first eight taxable years of a taxpayer beginning after December 31, 2005, and before January 1, 2014. For taxable years of a taxpayer beginning after December 31, 2011, the provision modifies the credit in two ways. First, the provision allows domestic corporations with operations in American Samoa to claim the credit even if those corporations are not existing credit claimants. Second, the credit is available to a domestic corporation (either an existing credit claimant or a new credit claimant) only if, in addition to satisfying all the present law requirements for claiming the credit, the corporation also has qualified production activities income (as defined in section 199(c) by substituting "American Samoa" for "the United States" in each place that latter term appears).

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

31. Bonus depreciation (sec. 331 of the Act and sec. 168(k) of the Code)

Present Law

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property placed in service between January 1, 2008 and September 8, 2010 or between January 1, 2012 and January 1, 2013 (January 1, 2014 for certain longer-lived and transportation property).[546] An additional

[545] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[546] Sec. 168(k). The additional first-year depreciation deduction is subject to the general rules regarding whether an item must be capitalized under section 263 or section 263A.

first-year depreciation deduction is allowed equal to 100 percent of the adjusted basis of qualified property if it meets the requirements for the additional first-year depreciation and also meets the following requirements. First, the taxpayer must acquire the property after September 8, 2010 and before January 1, 2012 (January 1, 2013 for certain longer-lived and transportation property).[547] Second, the taxpayer must place the property in service after September 8, 2010 and before January 1, 2012 (January 1, 2013 in the case of certain longer-lived and transportation property). Third, the original use of the property must commence with the taxpayer after September 8, 2010.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes, but is not allowed for purposes of computing earnings and profits. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2009, a taxpayer purchased new depreciable property and placed it in service.[548] The property's cost is $1,000, and it is five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed is $500. The remaining $500 of the cost of the property is depreciable under the rules applicable to five-year property. Thus, 20 percent, or $100, is also allowed as a depreciation deduction in 2009. The total depreciation deduction with respect to the property for 2009 is $600. The remaining $400 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements. First, the property must be (1) property to which MACRS applies with an applicable recovery period of 20 years or less; (2) water utility property (as defined in section 168(e)(5)); (3) computer software other than computer software covered by section 197; or (4) qualified leasehold improvement property (as defined in section 168(k)(3)).[549] Second, the original use[550] of the property must commence with

[547] For a definition of "acquire" for this purpose, see section 3.02(1)(a) of Rev. Proc. 2011–26, 2011–16 I.R.B. 664.

[548] Assume that the cost of the property is not eligible for expensing under section 179.

[549] The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. The additional first-year depreciation deduction is also not available for qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c)(2).

[550] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property).

the taxpayer after December 31, 2007.[551] Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2013. An extension of the placed-in-service date of one year (i.e., January 1, 2014) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.[552]

To qualify, property must be acquired (1) after December 31, 2007, and before January 1, 2013, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was entered into after December 31, 2007, and before January 1, 2013.[553] With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2013. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed-in-service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2013 ("progress expenditures") is eligible for the additional first-year depreciation deduction.[554]

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner. For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property other-

[551] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

[552] Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service-date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000.

[553] Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to January 1, 2008.

[554] For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

wise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year deduction).[555] The $8,000 increase is not indexed for inflation.

Special rule for long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method. Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service after December 31, 2009 and before January 1, 2011 (January 1, 2012 in the case of certain longer-lived and transportation property). Bonus depreciation is taken into account in determining taxable income under the percentage-of-completion method for property placed in service after December 31, 2010.

Election to accelerate minimum tax credit in lieu of claiming bonus depreciation

A corporation otherwise eligible for additional first year depreciation under section 168(k) may elect to claim additional minimum tax credits in lieu of claiming deprecation under section 168(k) for "eligible qualified property" placed in service after December 31, 2010 and before January 1, 2013 (January 1, 2014 in the case of certain longer-lived and transportation property).[556] A corporation making the election increases the limitation under section 53(c) on the use of minimum tax credits in lieu of taking bonus depreciation deductions. The increases in the allowable credits under this provision are treated as refundable. The depreciation for eligible qualified property is calculated for both regular tax and alternative minimum tax purposes using the straight-line method in place of the method that would otherwise be used absent the election under this provision.

The minimum tax credit limitation is increased by the bonus depreciation amount, which is equal to 20 percent of bonus depreciation[557] for certain eligible qualified property that could be claimed as a deduction absent an election under this provision.

The bonus depreciation amount is limited to the lesser of (1) $30 million or (2) six-percent of the minimum tax credits allocable to

[555] Sec. 168(k)(2)(F).

[556] Sec. 168(k)(4). Eligible qualified property means qualified property eligible for bonus depreciation with minor effective date differences.

[557] For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation for all eligible qualified property determined if section 168(k)(1) applied using the most accelerated depreciation method (determined without regard to this provision), and the shortest life allowable for each property, and (ii) the amount of depreciation that would be determined if section 168(k)(1) did not apply using the same method and life for each property.

the adjusted minimum tax imposed for, taxable years beginning before January 1, 2006. All corporations treated as a single employer under section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, section 168(k)(1) does not apply to any eligible qualified property and the straight-line method is used with respect to such property.

Generally an election under this provision for a taxable year applies to subsequent taxable years.[558]

Normalization accounting

Under present law, in order for public utility property to qualify for certain accelerated depreciation allowances for Federal income tax purposes, the benefits of accelerated depreciation must be normalized.[559] Normalization accounting as applied to accelerated tax depreciation generally requires regulatory tax expense to be computed using the depreciation methods and periods used for regulatory, rather than Federal income tax, purposes. Any deferred tax reserve resulting from the use of the normalization method of accounting may be used to reduce the rate base upon which a utility earns its rate of return.

Explanation of Provision

The provision extends the 50-percent additional first-year depreciation deduction for one year, generally through 2013 (through 2014 for certain longer-lived and transportation property).

The provision provides that solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less which is placed in service after December 31, 2012 and before January 1, 2014 (January 1, 2015, in the case of certain longer-lived and transportation property) is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted.

The provision also generally permits a corporation to increase the minimum tax credit limitation by the bonus depreciation amount with respect to certain property placed in service after December 31, 2012, and before January 1, 2014, (January 1, 2015 in the case of certain longer-lived and transportation property). The provision applies with respect to "round 3 extension property", which is defined as property that is eligible qualified property solely because it meets the requirements under the extension of the additional first-year depreciation deduction for certain property placed in service after December 31, 2012.[560]

Under the provision, a corporation that has previously made an election to claim credits in lieu of bonus depreciation may choose not to make this previous election apply for round 3 extension

[558] Special election rules apply as the result of prior extensions of this provision.
[559] Sec. 168(i)(9).
[560] An election under new section 168(k)(4)(J) with respect to round 3 extension property is binding for any property that is eligible qualified property solely by reason of the amendments made by section 331(a) of the Act (and the application of such extension to this paragraph pursuant to the amendment made by section 331(c)(1) of the Act), even if such property is placed in service in 2014.

property. The provision also allows a corporation that has not made a previous election to claim credits in lieu of bonus deprecation to make the election for round 3 extension property for its first taxable year ending after December 31, 2012, and for each subsequent year. A separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to round 3 extension property.[561]

The provision clarifies that for public utility property elections, such as an election out of bonus depreciation, must be respected in determining when normalization accounting may be used.

Effective Date

The provision is effective for property placed in service after December 31, 2012, in taxable years ending after such date.

TITLE IV—ENERGY TAX EXTENDERS

1. Credit for nonbusiness energy property (sec. 401 of the Act and sec. 25C of the Code)

Present Law

Present law[562] provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes. A qualified energy efficiency improvement is any energy efficiency building envelope component (1) that meets or exceeds the prescriptive criteria for such a component established by the 2009 International Energy Conservation Code as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009 (February 17, 2009) (or, in the case of windows, skylights and doors, and metal roofs with appropriate pigmented coatings or asphalt roofs with appropriate cooling granules, meets the Energy Star program requirements); (2) that is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) that reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling and which meet the prescriptive criteria for such material or system established by the 2009 International Energy Conservation Code, as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009 (February 17, 2009); (2) exterior windows (including skylights) and doors; and (3) metal or asphalt roofs with appropriate pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain for a dwelling.

Additionally, present law provides specified credits for the purchase of specific energy efficient property originally placed in serv-

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[561] In computing the maximum amount, the maximum increase amount for round 3 extension property is reduced by bonus depreciation amounts for preceding taxable years only with respect to round 3 extension property.

[562] Sec. 25C.

ice by the taxpayer during the taxable year. The allowable credit for the purchase of certain property is (1) $50 for each advanced main air circulating fan, (2) $150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $300 for each item of energy efficient building property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Energy-efficient building property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which achieves the highest efficiency tier established by the Consortium for Energy Efficiency, as in effect on January 1, 2009,[563] (3) a central air conditioner which achieves the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on Jan. 1, 2009,[564] (4) a natural gas, propane, or oil water heater which has an energy factor of at least 0.82 or thermal efficiency of at least 90 percent, and (5) biomass fuel property.

Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants), grasses, residues, and fibers.

The credit is available for property placed in service prior to January 1, 2012. The maximum credit for a taxpayer for all taxable years is $500, and no more than $200 of such credit may be attributable to expenditures on windows.

The taxpayer's basis in the property is reduced by the amount of the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, expenditures which are made from subsidized energy financing are not taken into account. The term "subsidized energy financing" means financing provided under a Federal, State, or local program a principal

[563] These standards are a seasonal energy efficiency ratio ("SEER") greater than or equal to 15, an energy efficiency ratio ("EER") greater than or equal to 12.5, and heating seasonal performance factor ("HSPF") greater than or equal to 8.5 for split heat pumps, and SEER greater than or equal to 14, EER greater than or equal to 12, and HSPF greater than or equal to 8.0 for packaged heat pumps.

[564] These standards are a SEER greater than or equal to 16 and EER greater than or equal to 13 for split systems, and SEER greater than or equal to 14 and EER greater than or equal to 12 for packaged systems.

purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

Reasons for Change [565]

Congress believes that extending the credit for energy efficient improvements and property expenditures will encourage homeowners to make their homes more energy efficient, thus helping to reduce residential energy consumption.

Explanation of Provision

The provision extends the credit for two years, through December 31, 2013.

Effective Date

The provision applies to property placed in service after December 31, 2011.

2. Alternative fuel vehicle refueling property (sec. 402 of the Act and sec. 30C of the Code)

Present Law

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer.[566] The credit may not exceed $30,000 per taxable year per location, in the case of qualified refueling property used in a trade or business and $1,000 per taxable year per location, in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel or electricity into the fuel tank or battery of a motor vehicle propelled by such fuel or electricity, but only if the storage or dispensing of the fuel or electricity is at the point of delivery into the fuel tank or battery of the motor vehicle. The original use of such property must begin with the taxpayer.

Clean-burning fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for one year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

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[565] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[566] Sec. 30C.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2012. In the case of hydrogen refueling property, the property must be placed in service before January 1, 2015.

Reasons for Change [567]

Congress believes that continuing to provide incentives for alternative fuel refueling property furthers America's environmental and energy independence goals by reducing gasoline consumption.

Explanation of Provision

The provision extends for two years (through 2013) the 30-percent credit for alternative fuel refueling property (other than hydrogen refueling property, the credit for which continues under present law through 2014).

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

3. Credit for electric motorcycles and three-wheeled vehicles (sec. 403 of the Act and sec. 30D of the Code)

Present Law

A 10-percent credit is available qualifying plug-in electric low-speed vehicles, motorcycles, and three-wheeled vehicles.[568] Two or three-wheeled vehicles must have a battery capacity of at least 2.5 kilowatt-hours. Other vehicles must have a battery capacity of at least 4 kilowatt-hours. The maximum credit for all qualifying vehicles is $2,500. The credit is part of the general business credit. The credit is available for vehicles acquired after February 17, 2009, and before January 1, 2012.

Reasons for Change [569]

Congress believes that continuing to provide incentives to electric motorcycles and three-wheeled vehicles furthers America's environmental and energy independence goals by reducing gasoline consumption.

Explanation of Provision

The provision combines the credit for electric motorcycles and three-wheeled vehicles (but not low-speed vehicles) with the section

[567] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[568] Sec. 30.

[569] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

30D credit for plug-in electric drive motor vehicles. The new credit provides the same incentives as the existing credit and expires for vehicles acquired on or before December 31, 2013.

Effective Date

The provision is effective for electric motorcycles and three-wheeled vehicles acquired after December 31, 2011.

4. Extension and modification of cellulosic biofuel producer credit (sec. 404 of the Act and sec. 40 of the Code)

Present Law

The "cellulosic biofuel producer credit" is a nonrefundable income tax credit for each gallon of qualified cellulosic fuel production of the producer for the taxable year. The amount of the credit is generally $1.01 per gallon.[570]

"Qualified cellulosic biofuel production" is any cellulosic biofuel which is produced by the taxpayer and which is: (1) sold by the taxpayer to another person (a) for use by such other person in the production of a qualified cellulosic biofuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or (c) who sells such cellulosic biofuel at retail to another person and places such cellulosic biofuel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (1)(a), (b), or (c).

"Cellulosic biofuel" means any liquid fuel that (1) is produced in the United States and used as fuel in the United States, (2) is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis, and (3) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency ("EPA") under section 211 of the Clean Air Act. Cellulosic biofuel does not include fuels that (1) are more than four percent (determined by weight) water and sediment in any combination, (2) have an ash content of more than one percent (determined by weight), or (3) have an acid number greater than 25 ("unprocessed or excluded fuels").[571]

The cellulosic biofuel producer credit cannot be claimed unless the taxpayer is registered by the Internal Revenue Service ("IRS") as a producer of cellulosic biofuel. The IRS permits a taxpayer to register as a cellulosic biofuel producer after the cellulosic biofuel has been produced. Thus, a person may register as a cellulosic biofuel producer in 2010 for cellulosic biofuel produced in 2009 and then claim the credit.

[570] In the case of cellulosic biofuel that is alcohol, the $1.01 credit amount is reduced by the credit amount of the alcohol mixture credit, and for ethanol, the credit amount for small ethanol producers, as in effect at the time the cellulosic biofuel fuel is produced. The alcohol mixture credit and small ethanol producer credits expired December 31, 2011, so there is no reduction for cellulosic biofuel that is alcohol if produced after December 31, 2011.

[571] Section 40(b)(6)(e)(iii). Water content (including both free water and water in solution with dissolved solids) is determined by distillation, using for example ASTM method D95 or a similar method suitable to the specific fuel being tested. Sediment consists of solid particles that are dispersed in the liquid fuel and is determined by centrifuge or extraction using, for example, ASTM method D1796 or D473 or similar method that reports sediment content in weight percent. Ash is the residue remaining after combustion of the sample using a specified method, such as ASTM D3174 or a similar method suitable for the fuel being tested.

Cellulosic biofuel eligible for the section 40 credit is precluded from qualifying as biodiesel, renewable diesel, or alternative fuel for purposes of the applicable income tax credit, excise tax credit, or payment provisions relating to those fuels.[572]

Because it is a credit under section 40(a), the cellulosic biofuel producer credit is part of the general business credits in section 38. However, the credit can only be carried forward three taxable years after the termination of the credit. The credit is also allowable against the alternative minimum tax. Under section 87, the credit is included in gross income. The cellulosic biofuel producer credit terminates on December 31, 2012.

Reasons for Change[573]

Congress believes that the cellulosic biofuel producer credit is an appropriate incentive to encourage the further development of biofuels on a commercial scale and that fuels from algae should be included within the scope of the incentive. Development of such fuels on a commercial scale will assist in securing energy independence by providing diversity in fuel sources.

Explanation of Provision

The provision extends the income tax credit for cellulosic biofuel for one additional year (through December 31, 2013). The provision makes a technical drafting correction by separately restating, apart from the general section 40 termination provisions, the rule that the cellulosic biofuel producer credit may only be carried forward three years after any termination of the cellulosic biofuel producer credit.

The provision expands qualified cellulosic biofuel production to include algae-based fuel. Producers of fuel derived from cultivated algae, cyanobacteria, or lemna will qualify for the cellulosic biofuel producer credit, a $1.01 income tax credit for each gallon of qualified cellulosic biofuel production. In addition, for algae-based fuel, the proposal expands qualified cellulosic biofuel production to include fuel derived from algae that is sold by the taxpayer to another person for refining by such other person into a fuel that meets the registration requirements for fuels and fuel additives under section 211 of the Clean Air Act. Thus, algae-based fuel sold for further refining, not just as end use as a fuel, would qualify for the credit.

Effective Date

The provision generally is effective on the date of enactment. The technical drafting correction is effective as if included in section 15321(b) of the Heartland, Habitat, Harvest, and Horticulture Act of 2008.

[572] See secs. 40A(d)(1), 40A(f)(3), and 6426(h).

[573] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

5. Incentives for biodiesel and renewable diesel (sec. 405 of the Act and secs. 40A, 6426, and 6427 of the Code)

Present Law

Biodiesel

Present law provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[574] The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The amount of the biodiesel fuels credit is includible in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit does not apply to fuel sold or used after December 31, 2011.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the EPA under section 211 of the Clean Air Act (42 U.S.C. sec. 7545) and (2) the requirements of the American Society of Testing and Materials ("ASTM") D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, camelina, or animal fats.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer or importer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.

Biodiesel mixture credit

The biodiesel mixture credit is $1.00 for each gallon of biodiesel (including agri-biodiesel) used by the taxpayer in the production of a qualified biodiesel mixture. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing such mixture. The sale or use must be in the trade or business of the taxpayer and is to be taken into account for the taxable year in which such sale or use occurs. No credit is allowed with respect to any casual off-farm production of a qualified biodiesel mixture.

Per IRS guidance a mixture need only contain 1/10th of one percent of diesel fuel to be a qualified mixture.[575] Thus, a qualified biodiesel mixture can contain 99.9 percent biodiesel and 0.1 percent diesel fuel.

Biodiesel credit (B–100)

The biodiesel credit is $1.00 for each gallon of biodiesel that is not in a mixture with diesel fuel (100 percent biodiesel or B–100)

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[574] Sec. 40A.

[575] Notice 2005–62, I.R.B. 2005–35, 443 (2005). "A biodiesel mixture is a mixture of biodiesel and diesel fuel containing at least 0.1 percent (by volume) of diesel fuel. Thus, for example, a mixture of 999 gallons of biodiesel and 1 gallon of diesel fuel is a biodiesel mixture."

and which during the taxable year is (1) used by the taxpayer as a fuel in a trade or business or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle.

Small agri-biodiesel producer credit

The Code provides a small agri-biodiesel producer income tax credit, in addition to the biodiesel and biodiesel mixture credits. The credit is 10 cents per gallon for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year. The agri-biodiesel must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified biodiesel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such agri-biodiesel at retail to another person and places such agri-biodiesel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[576] The credit is $1.00 for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. A biodiesel mixture is a mixture of biodiesel and diesel fuel that (1) is sold by the taxpayer producing such mixture to any person for use as a fuel or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.[577]

The credit is not available for any sale or use for any period after December 31, 2011. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

Payments with respect to biodiesel fuel mixtures

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit.[578] The biodiesel fuel mixture credit must first be taken against tax liability for taxable fuels. To the extent the biodiesel fuel mixture credit exceeds such tax liability, the excess may be received as a payment. Thus, if the person has no section 4081 liability, the credit is refundable. The Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2011.

Renewable diesel

"Renewable diesel" is liquid fuel that (1) is derived from biomass (as defined in section 45K(c)(3)), (2) meets the registration requirements for fuels and fuel additives established by the EPA under

[576] Sec. 6426(c).
[577] Sec. 6426(c)(4).
[578] Sec. 6427(e).

section 211 of the Clean Air Act, and (3) meets the requirements of the ASTM D975 or D396, or equivalent standard established by the Secretary. ASTM D975 provides standards for diesel fuel suitable for use in diesel engines. ASTM D396 provides standards for fuel oil intended for use in fuel-oil burning equipment, such as furnaces. Renewable diesel also includes fuel derived from biomass that meets the requirements of a Department of Defense specification for military jet fuel or an ASTM specification for aviation turbine fuel.

For purposes of the Code, renewable diesel is generally treated the same as biodiesel. In the case of renewable diesel that is aviation fuel, kerosene is treated as though it were diesel fuel for purposes of a qualified renewable diesel mixture. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.[579] The incentive for renewable diesel is $1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expire after December 31, 2011.

Reasons for Change[580]

Congress believes that extending the biodiesel and renewable diesel incentives through 2013 will give the industry certainty and allow for business planning.

Explanation of Provision

The provision extends the income tax credit, excise tax credit and payment provisions for biodiesel and renewable diesel for two years (through December 31, 2013).

Effective Date

The provision is effective for sales and uses after December 31, 2011.

6. Credit for the production of Indian coal (sec. 406 of the Act and sec. 45 of the Code)

Present Law

A credit is available for the production of Indian coal sold to an unrelated third party from a qualified facility for a seven-year period beginning January 1, 2006, and ending December 31, 2012. The amount of the credit for Indian coal is $1.50 per ton for the first four years of the seven-year period and $2.00 per ton for the last three years of the seven-year period. Beginning in calendar years after 2006, the credit amounts are indexed annually for inflation using 2005 as the base year. The credit amount for 2012 is $2.267 per ton.

A qualified Indian coal facility is a facility placed in service before January 1, 2009, that produces coal from reserves that on June 14, 2005, were owned by a Federally recognized tribe of Indi-

[579] Secs. 40A(f), 6426(c), and 6427(e).
[580] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

ans or were held in trust by the United States for a tribe or its members.

The credit is a component of the general business credit,[581] allowing excess credits to be carried back one year and forward up to 20 years. The credit is also subject to the alternative minimum tax.

Reasons for Change[582]

Congress believes that extending the credit for Indian coal will encourage continued mining of coal resources on Indian lands.

Explanation of Provision

The provision extends the credit for the production of Indian coal for one year (through December 31, 2013). The placed-in-service date for qualified facilities is not extended.

Effective Date

The provision is effective for Indian coal produced after December 31, 2012.

7. Extension and modification of incentives for renewable electricity property (sec. 407 of the Act and secs. 45 and 48 of the Code)

Present Law

Renewable electricity production credit

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the "renewable electricity production credit").[583] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

SUMMARY OF CREDIT FOR ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES

Eligible electricity production activity (sec. 45)	Credit amount for 2012[1] (cents per kilowatt-hour)	Expiration[2]
Wind	2.2	December 31, 2012
Closed-loop biomass	2.2	December 31, 2013
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1.1	December 31, 2013
Geothermal	2.2	December 31, 2013
Solar (pre-2006 facilities only)	2.2	December 31, 2005
Small irrigation power	1.1	December 31, 2013

[581] Sec. 38(b)(8).

[582] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[583] Sec. 45. In addition to the renewable electricity production credit, section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

SUMMARY OF CREDIT FOR ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES—Continued

Eligible electricity production activity (sec. 45)	Credit amount for 2012[1] (cents per kilowatt-hour)	Expiration[2]
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1.1	December 31, 2013
Qualified hydropower	1.1	December 31, 2013
Marine and hydrokinetic	1.1	December 31, 2013

[1] In general, the credit is available for electricity produced during the first 10 years after a facility has been placed in service.
[2] Expires for property placed in service after this date.

Municipal solid waste

One feedstock that can be used to generate credit-eligible renewable electricity is municipal solid waste. For this purpose, the term "municipal solid waste" has the meaning given the term "solid waste" under section 2(27) of the Solid Waste Disposal Act.[584] Under that Act, the term "solid waste" generally means any garbage, refuse, or sludge from a waste treatment plant, water supply treatment plant, or air pollution control facility and other discarded material, including solid, liquid, semisolid, or contained gaseous material resulting from industrial, commercial, mining, and agricultural operations, and from community activities, but does not include solid or dissolved material in domestic sewage, or solid or dissolved materials in irrigation return flows or industrial discharges.

Election to claim energy credit in lieu of renewable electricity production credit

A taxpayer may make an irrevocable election to have certain property which is part of a qualified renewable electricity production facility be treated as energy property eligible for a 30 percent investment credit under section 48. For this purpose, qualified facilities are facilities otherwise eligible for the renewable electricity production credit with respect to which no credit under section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the renewable electricity production credit. The eligible basis for the investment credit for taxpayers making this election is the basis of the depreciable (or amortizable) property that is part of a facility capable of generating electricity eligible for the renewable electricity production credit.

Reasons for Change[585]

Congress believes that building additional renewable energy infrastructure advances America's environmental and energy independence goals. Congress believes that additional renewable energy infrastructure will be built if the tax incentives for renewable energy are extended. Congress also believes that certain renewable power projects do not move forward because developers and investors are concerned that those projects cannot be completed before the renewable electricity production credit expires. Congress intends to reduce this uncertainty by replacing the placed-in-service

[584] Sec. 45(c)(6).
[585] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

expiration date with an expiration date based on when construction begins on a particular project. Finally, Congress is concerned that recyclable paper that has been segregated from the municipal solid waste stream may be diverted to trash combustion facilities. Congress seeks to prevent this from happening by modifying the definition of municipal solid waste to exclude such paper.

Explanation of Provision

The provision extends and modifies the expiration dates for the renewable electricity production credit and the 30-percent investment credit in lieu of such production credit. The provision extends the wind credits (production and investment) for one year, through December 31, 2013. In addition, the expiration date for all renewable power facilities (including wind facilities) is modified such that qualified facilities or property will be eligible for the renewable electricity production credit, or the investment credit in lieu of such credit, if the construction of such facilities or property begins before January 1, 2014.

The provision also modifies the definition of municipal solid waste to exclude commonly recycled paper that has been segregated from such waste for purposes of this credit.

Effective Date

The provision is effective on the date of enactment.

8. Credit for energy efficient new homes (sec. 408 of the Act and sec. 45L of the Code)

Present Law

Present law provides a credit to an eligible contractor for each qualified new energy-efficient home that is constructed by the eligible contractor and acquired by a person from such eligible contractor for use as a residence during the taxable year. To qualify as a new energy-efficient home, the home must be: (1) a dwelling located in the United States, (2) substantially completed after August 8, 2005, and (3) certified in accordance with guidance prescribed by the Secretary to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30-percent or 50-percent reduction in energy usage, compared to a comparable dwelling constructed in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on August 8, 2005, and any applicable Federal minimum efficiency standards for equipment. With respect to homes that meet the 30-percent standard, one-third of such 30-percent savings must come from the building envelope, and with respect to homes that meet the 50-percent standard, one-fifth of such 50-percent savings must come from the building envelope.

Manufactured homes that conform to Federal manufactured home construction and safety standards are eligible for the credit provided all the criteria for the credit are met. The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home.

The credit equals $1,000 in the case of a new home that meets the 30-percent standard and $2,000 in the case of a new home that meets the 50-percent standard. Only manufactured homes are eligible for the $1,000 credit.

In lieu of meeting the standards of chapter 4 of the 2003 International Energy Conservation Code, manufactured homes certified by a method prescribed by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program are eligible for the $1,000 credit provided criteria (1) and (2), above, are met.

The credit applies to homes that are purchased prior to January 1, 2012. The credit is part of the general business credit.

Reasons for Change[586]

Congress believes that extending the credit for energy efficient new homes will provide incentives for contractors and home manufacturers to produce such housing, thus helping to reduce residential energy consumption.

Explanation of Provision

The provision extends the credit to homes that are acquired prior to January 1, 2014. Additionally, the provision updates the home construction standard from the 2003 International Energy Conservation Code to the 2006 International Energy Conservation Code as in effect on January 1, 2006.

Effective Date

The provision applies to homes acquired after December 31, 2011.

9. Energy efficient appliance credit (sec. 409 of the Act and sec. 45M of the Code)

Present Law

In general

A credit is allowed for the eligible production of certain energy-efficient dishwashers, clothes washers, and refrigerators. The credit is part of the general business credit.

The credits are as follows:

Dishwashers

$45 in the case of a dishwasher that is manufactured in calendar year 2008 or 2009 that uses no more than 324 kilowatt hours per year and 5.8 gallons per cycle, and

$75 in the case of a dishwasher that is manufactured in calendar year 2008, 2009, or 2010 and that uses no more than 307 kilowatt hours per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings).

$25 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 307 kilowatt hours

[586] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings),

$50 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 295 kilowatt hours per year and 4.25 gallons per cycle (4.75 gallons per cycle for dishwashers designed for greater than 12 place settings), and

$75 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 280 kilowatt hours per year and 4 gallons per cycle (4.5 gallons per cycle for dishwashers designed for greater than 12 place settings).

Clothes washers

$75 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 that meets or exceeds a 1.72 modified energy factor and does not exceed a 8.0 water consumption factor, and

$125 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 or 2009 that meets or exceeds a 1.8 modified energy factor and does not exceed a 7.5 water consumption factor,

$150 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 that meets or exceeds a 2.0 modified energy factor and does not exceed a 6.0 water consumption factor, and

$250 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 that meets or exceeds a 2.2 modified energy factor and does not exceed a 4.5 water consumption factor.

$175 in the case of a top-loading clothes washer manufactured in calendar year 2011 which meets or exceeds a 2.2 modified energy factor and does not exceed a 4.5 water consumption factor, and

$225 in the case of a clothes washer manufactured in calendar year 2011 which (1) is a top-loading clothes washer and which meets or exceeds a 2.4 modified energy factor and does not exceed a 4.2 water consumption factor, or (2) is a front-loading clothes washer and which meets or exceeds a 2.8 modified energy factor and does not exceed a 3.5 water consumption factor.

Refrigerators

$50 in the case of a refrigerator manufactured in calendar year 2008 that consumes at least 20 percent but not more than 22.9 percent less kilowatt hours per year than the 2001 energy conservation standards,

$75 in the case of a refrigerator that is manufactured in calendar year 2008 or 2009 that consumes at least 23 percent but not more than 24.9 percent less kilowatt hours per year than the 2001 energy conservation standards,

$100 in the case of a refrigerator that is manufactured in calendar year 2008, 2009, or 2010 that consumes at least 25 percent but not more than 29.9 percent less kilowatt hours per year than the 2001 energy conservation standards, and

$200 in the case of a refrigerator manufactured in calendar year 2008, 2009, or 2010 that consumes at least 30 percent less energy than the 2001 energy conservation standards.

$150 in the case of a refrigerator manufactured in calendar year 2011 which consumes at least 30 percent less energy than the 2001 energy conservation standards, and

$200 in the case of a refrigerator manufactured in calendar year 2011 which consumes at least 35 percent less energy than the 2001 energy conservation standards.

Definitions

A dishwasher is any residential dishwasher subject to the energy conservation standards established by the Department of Energy. A refrigerator must be an automatic defrost refrigerator-freezer with an internal volume of at least 16.5 cubic feet to qualify for the credit. A clothes washer is any residential clothes washer, including a residential style coin operated washer, that satisfies the relevant efficiency standard.

The term "modified energy factor" means the modified energy factor established by the Department of Energy for compliance with the Federal energy conservation standard.

The term "gallons per cycle" means, with respect to a dishwasher, the amount of water, expressed in gallons, required to complete a normal cycle of a dishwasher.

The term "water consumption factor" means, with respect to a clothes washer, the quotient of the total weighted per-cycle water consumption divided by the cubic foot (or liter) capacity of the clothes washer.

Other rules

Appliances eligible for the credit include only those produced in the United States and that exceed the average amount of U.S. production from the two prior calendar years for each category of appliance. The aggregate credit amount allowed with respect to a taxpayer for all taxable years beginning after December 31, 2010, may not exceed $25 million, with the exception that the $200 refrigerator credit and the $225 clothes washer credit are not limited. Additionally, the credit allowed in a taxable year for all appliances may not exceed four percent of the average annual gross receipts of the taxpayer for the three taxable years preceding the taxable year in which the credit is determined.

Reasons for Change [587]

Congress believes that extending the credit for energy efficient appliances will spur their production and use, thus helping to reduce residential energy consumption.

Explanation of Provision

The provision extends the credits available for appliance production in 2011 for two additional years (through 2013), with the exception that the $25 dishwasher credit and the $175 clothes washer credit are not extended.

[587] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

Effective Date

The provision applies to appliances produced after December 31, 2011.

10. Extension of special depreciation allowance for cellulosic biofuel plant property (sec. 410 of the Act and sec. 168(l) of the Code)

Present Law

Present law[588] allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified cellulosic biofuel plant property. In order to qualify, the property generally must be placed in service before January 1, 2013.

Qualified cellulosic biofuel plant property means property used in the U.S. solely to produce cellulosic biofuel. For this purpose, cellulosic biofuel means any liquid fuel which is produced from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet the following requirements. The original use of the property must commence with the taxpayer on or after December 20, 2006. The property must be acquired by purchase (as defined under section 179(d)) by the taxpayer after December 20, 2006, and placed in service before January 1, 2013. Property does not qualify if a binding written contract for the acquisition of such property was in effect on or before December 20, 2006.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after December 20, 2006, and the property is placed in service before January 1, 2013 (and all other requirements are met). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103 is not eligible for the addi-

[588] Sec. 168(l).

tional first-year depreciation deduction.[589] Recapture rules apply if the property ceases to be qualified cellulosic biofuel plant property.[590]

Property with respect to which the taxpayer has elected 50 percent expensing under section 179C is not eligible for the additional first-year depreciation deduction.[591]

Reasons for Change[592]

Congress acknowledges that encouraging manufacturing of biofuels in the United States is important for fostering innovative new technology, encouraging energy independence, and creating manufacturing jobs in the United States. Further, expansion of the special depreciation allowance to include property related to algae-based fuels recognizes the potential of these fuels and supports their commercial production.

Explanation of Provision

The provision extends the present law special depreciation allowance for one year, to qualified cellulosic biofuel plant property placed in service prior to January 1, 2014. The provision expands the definition of qualified cellulosic biofuel plant property to include property used in the U.S. solely to produce algae-based fuel, including fuel derived from cultivated algae, cyanobacteria, or lemna.

Effective Date

The provision to extend the placed in service date is effective for property placed in service after December 31, 2012. The provision to expand the definition of qualified cellulosic biofuel plant property is effective for property placed in service after the date of enactment.

11. Special rule for sales or dispositions to implement FERC or State electric restructuring policy for qualified electric utilities (sec. 411 of the Act and sec. 451(i) of the Code)

Present Law

A taxpayer selling property generally recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility

[589] Sec. 168(l)(4)(C).
[590] Sec. 168(l)(7).
[591] Sec. 168(l)(8).
[592] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

property within the applicable period[593] (the "reinvestment property").[594] If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by a qualified electric utility to an independent transmission company prior to January 1, 2012. A qualified electric utility is defined as an electric utility, which as of the date of the qualifying electric transmission transaction, is vertically integrated in that it is both (1) a transmitting utility (as defined in the Federal Power Act)[595] with respect to the transmission facilities to which the election applies, and (2) an electric utility (as defined in the Federal Power Act).[596]

In general, an independent transmission company is defined as: (1) an independent transmission provider[597] approved by the Federal Energy Regulatory Commission ("FERC"); (2) a person (i) who the FERC determines under section 203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider no later than four years after the close of the taxable year in which the transaction occurs; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).

Exempt utility property is defined as: (1) property used in the trade or business of generating, transmitting, distributing, or selling electricity or producing, transmitting, distributing, or selling natural gas, or (2) stock in a controlled corporation whose principal trade or business consists of the activities described in (1). Exempt utility property does not include any property that is located outside of the United States.

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the reinvestment property may be purchased by any member of the affiliated group (in lieu of the taxpayer).

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[593] The applicable period for a taxpayer to reinvest the proceeds is the four year period beginning on the date the qualifying electric transmission transaction occurs.

[594] Sec. 451(i).

[595] 16 U.S.C. sec. 796 (23), defines "transmitting utility" as any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale.

[596] 16 U.S.C. sec. 796 (22), defines "electric utility" as any person or State agency (including any municipality) which sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

[597] For example, a regional transmission organization, an independent system operator, or an independent transmission company.

Reasons for Change[598]

Congress believes that the "unbundling" of electric transmission assets held by vertically integrated utilities, with the transmission assets ultimately placed under the ownership or control of independent transmission providers (or other similarly-approved operators), continues to be an important policy. To facilitate the implementation of this policy, Congress believes it is appropriate to assist taxpayers in moving forward with industry restructuring by providing a tax deferral for gain associated with certain dispositions of electric transmission assets.

Explanation of Provision

The provision extends for two years the treatment under the present-law deferral provision to sales or dispositions by a qualified electric utility that occur prior to January 1, 2014.

Effective Date

The provision applies to dispositions after December 31, 2011.

12. Alternative fuel and alternative fuel mixtures (sec. 412 of the Act and secs. 6426 and 6427(e) of the Code)

Present Law

Fuel excise taxes

Fuel excise taxes are imposed on taxable fuel (gasoline, diesel fuel or kerosene) under section 4081. In general, these fuels are taxed when removed from a refinery, terminal rack, upon entry into the United States, or upon sale to an unregistered person. A back-up tax under section 4041 is imposed on previously untaxed fuel and alternative fuel used or sold for use as fuel in a motor vehicle or motorboat to the supply tank of a highway vehicle. In general, the rates of tax are 18.3 cents per gallon (or in the case of compressed natural gas 18.3 cents per gasoline gallon equivalent), and in the case of liquefied natural gas, and liquid fuel derived from coal or biomass, 24.3 cents per gallon.

Alternative fuel and alternative fuel mixture credits and payments

The Code provides two per-gallon excise tax credits with respect to alternative fuel: the alternative fuel credit, and the alternative fuel mixture credit. For this purpose, the term "alternative fuel" means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process ("coal-to-liquids"), compressed or liquefied gas derived from biomass, or liquid fuel derived from biomass. Such term does not include ethanol, methanol, or biodiesel.

[598] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

For coal-to-liquids produced after December 30, 2009, the fuel must be certified as having been derived from coal produced at a gasification facility that separates and sequesters 75 percent of such facility's total carbon dioxide emissions.

The alternative fuel credit is allowed against section 4041 liability, and the alternative fuel mixture credit is allowed against section 4081 liability. Neither credit is allowed unless the taxpayer is registered with the Secretary. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents[599] of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat, sold for use in aviation or so used by the taxpayer.

The alternative fuel mixture credit is 50 cents per gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. An "alternative fuel mixture" is a mixture of alternative fuel and taxable fuel (gasoline, diesel fuel or kerosene) that contains at least 1⁄10 of one percent taxable fuel. The mixture must be sold by the taxpayer producing such mixture to any person for use as a fuel, or used by the taxpayer producing the mixture as a fuel. The credits generally expire after December 31, 2011 (September 30, 2014 for liquefied hydrogen).

A person may file a claim for payment equal to the amount of the alternative fuel credit and alternative fuel mixture credits. The alternative fuel credit and alternative fuel mixture credit must first be applied to the applicable excise tax liability under section 4041 or 4081, and any excess credit may be taken as a payment. These payment provisions generally also expire after December 31, 2011. With respect to liquefied hydrogen, the payment provisions expire after September 30, 2014.

For purposes of the alternative fuel credit, alternative fuel mixture credit and related payment provisions, "alternative fuel" does not include fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp.

Reasons for Change[600]

Congress believes it is appropriate to extend the incentives for alternative fuel to provide certainty to the industry and allow for business planning. It has come to the attention of Congress that the refundable aspect of the alternative fuel mixture credit, in combination with requiring only 1⁄10 of one percent of diesel fuel to qualify as a mixture, has encouraged taxpayers to be aggressive in making large and questionable claims for payment.[601] Because the claims can be made weekly and are subject to interest if not paid timely, it is the understanding of Congress that these circumstances result in the IRS often examining such claims after payment and having to recover an erroneous overpayment. If the payment cannot be recovered from the taxpayer, it results not only

[599] "Gasoline gallon equivalent" means, with respect to any nonliquid alternative fuel (for example, compressed natural gas), the amount of such fuel having a Btu (British thermal unit) content of 124,800 (higher heating value).

[600] See S. 3521, the "Family and Business Tax Cut Certainty Act of 2012," which was reported by the Senate Finance Committee on August 28, 2012 (S. Rep. No. 112–208).

[601] For an example of aggressive claims relating to alternative fuel mixtures see IRS Chief Counsel Advice 201133010, 2011 WL 3636293 (July 12, 2011).

in administrative expenses to the Federal Government, but a loss of revenue as well. Therefore, Congress believes that to deter abusive claims for payment, it is appropriate not to extend the outlay payments for alternative fuel mixtures.

Explanation of Provision

The provision extends the alternative fuel excise tax credit, and related payment provisions (for non-hydrogen fuels), for two additional years (through December 31, 2013). The alternative fuel mixture excise tax credit is extended for two additional years (through December 31, 2013) but the companion payment (outlay) provision is not extended.

Effective Date

The provision is effective for fuel sold or used after December 31, 2011.

TITLE IX—BUDGET PROVISION

1. Amounts in applicable retirement plans may be transferred to designated Roth accounts without distribution (sec. 902 of the Act and sec. 402A of the Code)

Present Law

Individual retirement arrangements

There are two basic types of individual retirement arrangements ("IRAs") under present law: traditional IRAs,[602] to which both deductible and nondeductible contributions may be made,[603] and Roth IRAs, to which only nondeductible contributions may be made.[604] An annual limit applies to contributions to IRAs.[605]

The principal difference between these two types of IRAs is the timing of income tax inclusion. For a traditional IRA, an eligible contributor may deduct the contributions made for the year, but distributions are includible in gross income and may be subject to the 10-percent additional tax on early distributions.[606] For a Roth IRA, all contributions are after-tax (no deduction is allowed) but amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income or subject to the 10-percent early withdrawal tax. A qualified distribution is a distribution that (1) is made after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to

[602] Sec. 408.
[603] Sec. 219.
[604] Sec. 408A.
[605] The contribution limit is coordinated so that the aggregate maximum amount that can be contributed to all of an individual's IRAs (both traditional and Roth IRAs) for a taxable year is the lesser of a certain dollar amount ($5,500 for 2013) or the individual's compensation. In the case of a married couple, contributions can be made up to the dollar limit for each spouse if the combined compensation of the spouses is at least equal to the contributed amount. An individual who has attained age 50 before the end of the taxable year may also make catch-up contributions to an IRA. For this purpose, the aggregate dollar limit is increased by $1,000. In addition, deductible contributions to traditional IRAs, and contributions to Roth IRAs, generally are subject to AGI limits. IRA contributions generally must be made in cash.
[606] Under section 72(t), unless another exception applies, distributions from IRAs, qualified retirement plans, and section 403(b) plans before the employee or IRA owner attains age 59½ are subject to an additional tax equal to 10 percent of the amount of the distribution that is includible in gross income.

a Roth IRA, and (2) is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings.[607] Under special ordering rules, after-tax contributions are recovered before earnings rather than being recovered pro rata with earnings.[608] The amount includible in income is also subject to the 10-percent early withdrawal tax unless an exception applies.

Roth IRA conversions

Taxpayers generally may convert amounts in a traditional IRA that are eligible for rollover.[609] A conversion may be accomplished by means of a 60-day rollover,[610] trustee-to-trustee transfer, or account redesignation. Regardless of the means used to convert, any amount converted from a traditional IRA to a Roth IRA is treated as distributed from the traditional IRA and rolled over to the Roth IRA. The amount converted is includible in income as if a withdrawal had been made, except that the 10-percent early withdrawal tax does not apply. A special recapture rule relating to the 10-percent additional tax on early distributions applies for distributions made from a Roth IRA within a specified five-year period after a rollover.[611]

Qualified Roth contribution programs

Section 401(k) plans, section 403(b) plans, and governmental section 457(b) plans

A qualified retirement plan[612] that is a profit-sharing plan or stock bonus plan (and certain money purchase pension plans) may allow an employee to make an election between cash and an employer contribution to the plan pursuant to a qualified cash or deferred arrangement.[613] A plan with this feature is generally referred to as a section 401(k) plan. A section 403(b) plan may allow a similar salary reduction agreement under which an employee may make an election between cash and an employer contribution to the plan.[614]

Amounts contributed pursuant to these qualified cash or deferred arrangements and salary reduction agreements generally are referred to as elective contributions. The elective contributions generally are excludable from gross income (pretax elective contribu-

[607] This tax treatment applies also to distributions from a traditional IRA to which nondeductible contributions were made, with the portion attributable to earnings determined on a pro rata basis.

[608] Sec. 408A(d)(4).

[609] Under section 408(d)(3), most distributions from an IRA are eligible for rollover. The exceptions are distribution to a beneficiary other than a surviving spouse and distributions that are required minimum distributions.

[610] A 60-day rollover is a rollover under which an amount distributed that is eligible for rollover is contributed to an eligible retirement plan within 60 days of the distribution. See section 408(d)(3)(A)(ii) and section 402(c)(3).

[611] Sec. 408A(d)(3)(F), Treas. Reg. sec. 1.408A–6, A–5, and Notice 2008–30, Q&A–3.

[612] Qualified retirement plans include plans qualified under section 401(a) and section 403(a) annuity plans.

[613] Sec. 401(k).

[614] Section 403(b) plans may be maintained only by (1) tax-exempt charitable organizations, and (2) educational institutions of State or local governments (including public schools). Many of the rules that apply to section 403(b) plans are similar to the rules applicable to qualified retirement plans, including section 401(k) plans.

tions) and only taxed along with attributable earnings upon distribution from the plan. Alternatively the plan may include a qualified Roth contribution program under which eligible employees are offered a choice of either making pretax elective contributions or making elective contributions that are not excluded from income and are designated as Roth contributions.[615] Similar to distributions from Roth IRAs, if certain requirements are satisfied, distributions of designated Roth contributions and attributable earnings are excluded from gross income. The employer may also make nonelective and matching contributions for employees under a section 401(k) or 403(b) plan. These are not permitted to be designated as Roth contributions and generally are pretax contributions.

A dollar limit applies to the aggregate amount of elective contributions that an employee is permitted to contribute to section 401(k) and section 403(b) plans for a taxable year, which is $17,500 for 2013.[616] An additional catch-up amount that employees age 50 or over are allowed to contribute is $5,500 for 2013.[617]

Elective contributions under a section 401(k) plan are subject to explicit statutory in-service distribution restrictions under the plan.[618] Such contributions generally may only be distributed after attainment of age 59½, death of the employee, termination of the plan, or severance from employment with the employer maintaining the plan. These contributions are also permitted to be distributed on account of hardship. These limitations also apply to certain other contributions to the plan except that such distributions cannot be distributed on account of hardship. Similar distribution restrictions apply to salary reduction contributions under section 403(b) plans.[619]

Amounts under a qualified plan are distributable only as permitted under the plan terms. Even if no other statutory distribution restriction applies to an amount, in order to meet the regulatory definition for a profit-sharing plan, the plan generally may only allow an in-service distribution of an amount contributed to the plan after a fixed number of years (not less than two).[620] In the case of a money purchase pension plan, the plan generally may not allow an in-service distribution prior to attainment of age 62 (or attainment of normal retirement age under the plan if earlier).[621]

The Thrift Savings Plan ("TSP") is a qualified defined contribution plan under which Federal employees may make elective contributions.[622] TSP includes a qualified Roth contribution program and allows employees to make both pretax elective contributions

[615] Sec. 402A.

[616] An employee with compensation less than $17,500 may make elective contributions only up to the amount of his or her compensation. Pursuant to section 415(c) and 403(b)(1), total contributions (including elective contributions) for an employee to a section 401(k) plan or 403(b) plan for a plan year for an employee generally cannot exceed $51,000 for 2013 (or the employee's compensation, if less). In some cases additional elective contributions or other contributions may be made under a section 403(b) plan.

[617] The total of an employee's elective contributions, including catch-up contributions, cannot exceed the employee's compensation.

[618] Sec. 401(k)(2)(B).

[619] Secs. 403(b)(7)(A)(ii) and 403(b)(11).

[620] Rev. Rul. 71–295, 1971–2, C.B. 184 and Treas. Reg. sec. 1.401–1(b)(1)(ii). Similar rules apply to a stock bonus plan. Treas. Reg. sec. 1.401–1(b)(1)(iii).

[621] Sec. 401(a)(37) and Treas. Reg. sec. 1.401(a)–1(b)(1).

[622] The provisions of TSP are governed by sections 8430 through 8440f of Title 5 of the United States Code.

and designated Roth contributions (subject to the applicable limit). These contributions are generally subject to the same tax treatment as contributions to a section 401(k) plan.[623] The TSP also provides for employer matching contributions and nonelective contributions. Distributions from the TSP are permitted after separation from employment or attainment of age 59½ or in the case of financial hardship.[624]

A governmental section 457(b) plan may also provide for elective contributions. Contributions to a governmental section 457(b) plan are subject to a dollar limit of $17,500 for 2013 plus an additional $5,500 catch-up contribution limit for participants at least age 50 (or the participant's compensation, if less).[625] This limit is separate from the limit on elective deferrals to section 401(k) and section 403(b) plans.[626] As in the case of a section 401(k) plan or a section 403(b) plan, the plan may include a qualified Roth contribution program under which employees are given the choice between making pretax elective contributions and designated Roth contributions. Deferrals under a governmental section 457(b) plan are also subject to explicit statutory in-service distribution restrictions similar to those applicable to section 401(k) and 403(b) plans, except that distributions from a governmental section 457(b) plan prior to severance from employment are generally not permitted until the employee attains age 70½ (rather than being allowed after attainment of age 59½).[627]

Designated Roth accounts

All designated Roth contributions made under the plan must be maintained in a separate account (a designated Roth account). A qualified distribution from a designated Roth account is excludable from gross income. A qualified distribution is a distribution that is made after (1) an employee's completion of a specified 5-year period and (2) the employee's attainment of age 59½, death, or disability.

A distribution from a designated Roth account (other than a qualified distribution) is included in the distributee's gross income to the extent allocable to income under the contract and excluded from gross income to the extent allocable to investment in the contract (commonly referred to as basis), taking into account only the designated Roth contributions as basis.[628]

Eligible rollover distributions from designated Roth accounts may only be rolled over to another designated Roth account or a Roth IRA.

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[623] Sec 7701(j).
[624] 5 U.S.C. sec. 8433.
[625] Under a special rule, additional catch-up contributions may be made by a participant to a governmental section 457(b) for the last three years before attainment of normal retirement age.
[626] For example, if an employee participates in both a section 403(b) plan and a governmental section 457(b) plan of the same employer, the employee may contribute up to $17,500 (plus $5,500 catch-up contributions if at least age 50) to the section 403(b) plan and up to $17,000 (plus $5,500 catch-up contributions if at least age 50) to the section 457(b) plan.
[627] Sec. 457(d)(1)(A).
[628] The special basis-first recovery rule for Roth IRAs does not apply to distributions from designated Roth accounts.

Rollovers from eligible employer plans (other than from designated Roth accounts)

Rollover to eligible retirement plan that is not a Roth IRA or a designated Roth account

An eligible rollover distribution from an eligible employer plan that is not from a designated Roth account may be rolled over to another such plan (other than to a designated Roth account) or to a traditional IRA. An eligible employer plan is a qualified retirement plan, a section 403(b) plan, and a governmental section 457(b) plan. If rolled over, the distribution generally is not currently includible in the distributee's gross income. An eligible rollover distribution is any distribution from an eligible employer plan with certain exceptions. Distributions that are not eligible rollover distributions generally are certain periodic payments, any distribution to the extent the distribution is a minimum required distribution, and any distribution made on account of hardship of the employee.[629] Only an employee, a surviving spouse, or certain alternate payees are allowed to roll over an eligible rollover distribution from an eligible employer plan to another eligible employer plan.[630]

Rollover to a Roth IRA

A distribution from an eligible employer plan that is not from a designated Roth account is also permitted to be rolled over into a Roth IRA, subject to the rules that apply to conversions from a traditional IRA into a Roth IRA. Thus, a rollover from an eligible employer plan into a Roth IRA is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10-percent early distribution tax does not apply.[631] In the case of a distribution and rollover of property, the amount of the distribution for purposes of determining the amount includable in gross income is generally the fair market value of the property on the date of the distribution.[632] As in the case of a Roth IRA conversion of an amount from a traditional IRA, the special recapture rule relating to the 10-percent additional tax on early distributions applies for distributions made from the Roth IRA within a specified five-year period after the rollover.[633]

In-plan Roth rollover

If a section 401(k) plan, section 403(b) plan, or governmental section 457(b) plan has a qualified Roth contribution program, any amount eligible under the plan for distribution and rollover to another eligible employer plan is permitted to be rolled over from an account under the plan that is not a designated Roth account into a designated Roth account under the plan for the individual (referred to as an "in-plan Roth rollover").[634] As in the case of a rollover of a distribution from an eligible employer plan (other than from a designated Roth Account) to a Roth IRA, this rollover is es-

[629] Sec. 402(c)(4).
[630] Section 402(c)(10) allows nonspouse beneficiaries to make a direct rollover to an IRA but not another eligible employer plan.
[631] Sec. 408A(d)(3) and Notice 2008–30, 2008–12 I.R.B. 638.
[632] Treas. Reg. sec. 1.402(a)–1(a)(iii).
[633] Sec. 408A(d)(3)(F), Treas. Reg. sec. 1.408A–6 A–5, and Notice 2008–30, Q&A–3.
[634] Sec. 402A(c)(4). Notice 2010–84, 2010–2 C.B. 872, provides guidance on section 402A(c)(4).

sentially a form of Roth conversion, and the distribution is subject to the rules that apply to conversions from a traditional IRA into a Roth IRA. Thus, the amount transferred is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10-percent early distribution tax does not apply.[635] An in-plan Roth rollover may be accomplished at the election of the employee (or surviving spouse) through a direct rollover (operationally through a transfer of assets from the account that is not a designated Roth account to the designated Roth account) (an "in-plan Roth direct rollover"), or by a distribution of funds to the individual who then rolls over the funds into his or her designated Roth account in the plan within 60 days (an "in-plan Roth 60-day rollover").

A plan that does not otherwise have a qualified Roth contribution program is not permitted to establish designated Roth accounts solely to accept these rollover contributions. Further, whether the rollover is an in-plan Roth direct rollover or an in-plan Roth 60-day rollover, the distribution to be rolled over must be otherwise allowed under the plan and be an eligible rollover distribution. For example, an amount under a section 401(k) plan subject to distribution restrictions cannot be rolled over to a designated Roth account. If property is transferred in a direct in-plan Roth rollover, the individual must be eligible for an in-kind distribution of that property. If the direct rollover is accomplished by a transfer of property to the designated Roth account (rather than cash), the amount of the distribution is the fair market value of the property on the date of the transfer. A plan is permitted to allow a distribution only in the form of a direct in-plan Roth rollover even though the plan does not otherwise allow in-service distributions or distributions prior to normal retirement age.[636]

Because an in-plan Roth direct rollover merely changes the account in a plan under which an amount is held and the tax character of the amount, a distribution that is rolled over in an in-plan direct rollover is not treated as a distribution for certain purposes under the plan, including certain purposes related to participant or spousal consent, plan loans, and anti-cut back protections under the plan.[637]

Explanation of Provision

The provision expands the amounts eligible for in-plan Roth direct rollover to include amounts that are not distributable under the plan. Under the provision, a section 401(k) plan (including TSP), a section 403(b) plan or a governmental section 457(b) plan that includes a qualified Roth contribution program is permitted to allow individuals to elect an in-plan transfer of any amount not otherwise distributable under the plan from an account that is not a designated Roth account under the plan to a designated Roth account maintained under the plan for the benefit of the individual.

[635] As in the case of a rollover from an eligible employer plan that is not from a designated Roth account to a Roth IRA, the special recapture rule relating to the 10-percent additional tax on early distributions applies.
[636] Q&A–4 of Notice 2010–84.
[637] Q&A–3 of Notice 2010–84.

This in-plan transfer is treated as an in-plan Roth direct rollover, even though the plan may not otherwise be allowed to provide for distribution of the amount transferred. Thus, as in the case of present-law in-plan Roth direct rollovers, the transfer is essentially a form of Roth conversion, and the amount transferred is subject to the rules that apply to conversions from a traditional IRA into a Roth IRA. Thus, the amount transferred is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10-percent early distribution tax does not apply unless the special recapture rule applies based on a subsequent distribution.

The provision specifies that a plan is not treated as violating the distribution restrictions applicable to section 401(k), 403(b) and governmental section 457(b) plans solely by reason of an in-plan transfer under the provision. An in-plan transfer under the provision is also permitted for an amount that is not distributable for any other reason. For example, if an amount in a profit-sharing plan is not distributable because the requisite fixed number of years have not elapsed, the plan would not be treated as violating this distribution limitation solely by reason of an in-plan transfer of such amount under the provision. Moreover, the statutory provision governing TSP distributions is not violated solely by reason of an in-plan transfer under the provision.

Similar to an in-plan Roth direct rollover for otherwise distributable amounts, an amount transferred in an in-plan transfer under the provision merely changes the account in a plan under which an amount is held and the tax character of the amount. Thus, the provision does not change the basic character of these amounts as not being distributable under the plan. For example, an amount subject to a distribution restriction in a section 401(k), section 403(b) or governmental section 457(b) plan before an in-plan transfer must remain subject to the relevant distribution restriction after the transfer. As a further example, an amount in a profit-sharing plan that is not distributable because the requisite fixed number of years has not elapsed remains not distributable for the remainder of the fixed number of years.

Effective Date

The provision applies to transfers after December 31, 2012, in taxable years ending after that date.

PART THIRTEEN: CUSTOMS USER FEES AND CORPORATE ESTIMATED TAXES

A. Extension of Custom User Fees

Present Law

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA")[638] authorized the Secretary of the Treasury to collect certain service fees. Section 412 of the Homeland Security Act of 2002[639] authorized the Secretary of the Treasury to delegate such authority to the Secretary of Homeland Security. These fees include: processing fees for air and sea passengers, commercial trucks, rail cars, private aircraft and vessels, commercial vessels, dutiable mail packages, barges and bulk carriers, merchandise, and Customs broker permits.[640] COBRA was amended on several occasions but most recently prior to the start of the 112th Congress by the Omnibus Trade Act of 2010,[641] which extended authorization for the collection of the passenger and conveyance fees through January 14, 2020 and the merchandise processing fees through January 7, 2020.

Explanation of Provision

Public Law Number 112–40 increases the maximum authorized processing fee for merchandise that is formally entered or released, from 0.21 to 0.3464 percent ad valorem, for the period beginning October 1, 2011 and ending November 30, 2015.[642] It also decreases the same maximum authorized processing fee, from 0.21 to 0.1740 percent ad valorem, for the period beginning October 1, 2016 and ending September 30, 2019.[643]

Effective Date

The provision is effective on the date of enactment (October 21, 2011).

Explanation of Provision

The United States-Korea Free Trade Agreement Implementation Act extends: (1) the passenger and conveyance processing fees authorized under COBRA through December 8, 2020; and (2) the mer-

[638] Pub. L. No. 99–272.
[639] Pub. L. No. 107–296
[640] 19 U.S.C. sec. 58c.
[641] Pub. L. No. 111–344.
[642] Pub. L. No. 112–40, secs. 2 & 262.
[643] Pub. L. No. 112–40, sec. 262.

chandise processing fees authorized under COBRA through August 2, 2021.[644]

It also increases the maximum authorized processing fee for merchandise that is formally entered or released, from 0.21 to 0.3464 percent ad valorem, for the period beginning December 1, 2015 and ending June 30, 2021.[645]

Effective Date

The provision is effective on the date of enactment (October 21, 2011).

Explanation of Provision

Public Law Number 112–163 extends: (1) the passenger and conveyance processing fees authorized under COBRA through October 29, 2021; and (2) the merchandise processing fees authorized under COBRA through October 22, 2021.[646]

Effective Date

The provision is effective on the date of enactment (August 10, 2012).

B. Time for Payment of Corporate Estimated Taxes

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability.[647] For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15. In the case of a corporation with assets of at least $1 billion (determined as of the end of the preceding taxable year):[648]

1. payments due in July, August, or September, 2014, are increased to 174.25 percent of the payment otherwise due;
2. payments due in July, August or September, 2015, are increased to 163.75 percent of the payment otherwise due; and
3. payments due in July, August or September, 2019, are increased to 106.5 percent of the payment otherwise due.

For each of the periods impacted, the next required payment is reduced accordingly.

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[644] Pub. L. No. 112–41, sec. 504.

[645] Pub. L. No. 112–41, sec. 503.

[646] Pub. L. No. 112–163, sec. 5. This section also repeals two provisions that were enacted earlier in the term. Those provisions authorized the passenger and conveyance fees and the merchandise processing fees for specified periods during calendar years 2020 and 2021, notwithstanding the general termination provision. See United States-Colombia Trade Promotion Agreement Implementation Act, Pub. L. No. 112–42, sec. 602; United States-Panama Trade Promotion Agreement Implementation Act, Pub. L. No. 112–43, sec. 501.

[647] Sec. 6655.

[648] See also Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress (JCS–2–11), March 2011, pp. 698–701, and Part Ten of this General Explanation.

Explanation of Provision

The United States-Korea Free Trade Agreement Implementation Act[649] increases the amount of the required installment of estimated tax otherwise due in July, August, or September of 2012 by 0.25 percent of such amount and the amount of the required installment of estimated tax otherwise due in July, August, or September of 2016 by 2.75 percent of such amount (determined without regard to any increase in such amount not contained in the Internal Revenue Code). The next required installment is reduced accordingly.

Effective Date

The provision is effective on the date of enactment of the Act.

Explanation of Provision

The United States-Colombia Trade Promotion Agreement Implementation Act[650] increases the amount of the required installment of estimated tax otherwise due in July, August, or September, 2016, by 0.50 percent of such amount (determined without regard to any increase in such amount not contained in the Internal Revenue Code). The next required installment is reduced accordingly.

Effective Date

The provision is effective on the date of enactment of the Act.

Explanation of Provision

The United States—Panama Trade Promotion Agreement Implementation Act[651] increases the amount of the required installment of estimated tax otherwise due in July, August, or September, 2012 by 0.25 percent of such amount and the amount of the required installment of estimated tax otherwise due in July, August, or September of 2016 by 0.25 percent of such amount (determined without regard to any increase in such amount not contained in the Internal Revenue Code). The next required installment is reduced accordingly.

Effective Date

The provision is effective on the date of enactment of the Act.

Explanation of Provision

The Middle Class Tax Relief and Job Creation Act of 2012[652] reduces the applicable percentage for 2012 (100.5 percent), 2014 (174.25 percent), 2015 (163.75 percent), 2016 (103.5 percent), and 2019 (106.5 percent) to 100 percent. Thus, corporations will be required to make estimated tax payments in 2012, 2014, 2015, 2016, and 2019 as if the prior legislation had never been enacted or amended.

[649] Pub. L. No. 112–41, sec. 505.
[650] Pub. L. No. 112–42, sec. 603.
[651] Pub. L. No. 112–43, sec. 502.
[652] Pub. L. No. 112–96, sec. 7001.

Effective Date

The provision is effective on the date of enactment of the Act.

Explanation of Provision

The African Growth and Opportunity Act[653] increases the amount of the required installment of estimated tax otherwise due in July, August, or September, 2017, by 0.25 percent of such amount (determined without regard to any increase in such amount not contained in the Internal Revenue Code). The next required installment is reduced accordingly.

Effective Date

The provision is effective on the date of enactment of the Act.

[653] Pub. L. No. 112–163, sec. 4.

APPENDIX: ESTIMATED BUDGET EFFECTS OF TAX LEGISLATION ENACTED IN THE 112TH CONGRESS

APPENDIX:
ESTIMATED BUDGET EFFECTS OF TAX LEGISLATION ENACTED IN THE 112TH CONGRESS

Fiscal Years 2011- 2022

[Millions of Dollars]

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
PART ONE: HIGHWAY TRUST FUND RELATED LEGISLATION EXTENSIONS (P.L. 112-5, signed into law by the President on March 4, 2011; P.L. 112-30, signed into law by the President on September 16, 2011; P.L. 112-102, signed into law by the President on March 30, 2012; P.L. 112-140, signed into law by the President on June 29, 2012; and P.L. 112-141, signed into law by the President on July 6, 2012)														
A. Short-Term Extensions of Highway Trust Fund Expenditure and Tax Authority (P.L. 112-5, 112-30, 112-102, 112-140 and 112-141)...	DOE	---------- *No Revenue Effect* ----------												
B. Short-Term Extensions of the Leaking Underground Storage Tank Trust Fund Financing Rate (P.L. 112-30, 112-102, and 112-140)...	DOE	---------- *No Revenue Effect* ----------												
C. Revenue Provisions in the Moving Ahead for Progress in the 21st Century Act or the ''MAP–21'' (P.L. 112-141)														
1. Extension of Highway Trust Fund expenditure authority and related taxes:														
a. Extension of trust fund expenditure authority (sunset 9/30/14)...	7/1/12	---------- *No Revenue Effect* ----------												
b. Extension of highway-related taxes (sunset 9/30/16) [1]...	7/1/12	---------- *No Revenue Effect* ----------												
2. Transfer $2.4 billion from the Leaking Underground Storage Tank Trust Fund to the highway account of the Highway Trust Fund..	DOE	---------- *No Revenue Effect* ----------												
3. Pension provisions:														
a. Pension funding stabilization (interest rate within specified percentage of 25-year average) [2]......................	pyba 12/31/11	---	595	2,391	4,576	5,144	3,765	1,671	274	-807	-2,328	-3,121	-2,766	9,394
b. PBGC premiums [3]:														
1. Cap single-employer variable-rate premiums................	pyba 2012	---	---	---	-140	-260	-280	-130	-60	-20	-10	-10	-10	-920
2. Single-employer program:														
a. Increase flat-rate premiums.......................................	pyba 2012	---	---	200	400	400	500	530	570	600	630	630	670	5,130
b. Variable-rate premiums..	pyba 2012	---	---	---	---	760	1190	810	570	370	290	330	390	4,710
3. Multiemployer program - increase flat-rate premiums...	pyba 2012	---	---	20	15	15	25	25	25	30	30	30	40	255
4. Interaction..	---	---	---	---	---	50	227	231	256	208	209	159	110	1,450
4. Extend and modify transfer of excess pension assets to retiree health accounts (sunset 12/31/21) and allow section 420 to apply to life insurance benefits........................	tma DOE	---	---	---	20	41	42	43	44	45	47	48	24	354

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
5. Additional transfers to the Highway Trust Fund......................	DOE	--- *No Revenue Effect*												
6. Exception to early distribution tax for phased retirement annuities and composite retirement annuities under new Federal phased retirement program..	DOE	--- *Negligible Revenue Effect*												
7. Expand the definition of a tobacco manufacturer to include businesses making available roll-your-own cigarette machines for consumer use..	ara DOE	---	2	12	13	11	10	9	8	7	7	7	7	94
TOTAL OF PART ONE..		**---**	**597**	**2,623**	**4,884**	**6,161**	**5,479**	**3,189**	**1,687**	**433**	**-1,125**	**-1,927**	**-1,535**	**20,467**
PART TWO: AIRPORT AND AIRWAY TRUST FUND SHORT-TERM EXTENSIONS (P.L. 112-7, signed into law by the President on March 31, 2011; P.L. 112-16, signed into law by the President on May 31, 2011; P.L. 112-21, signed into law by the President on June 29, 2011; P.L. 112-27, signed into law by the President on August 5, 2011; P.L. 112-30, signed into law by the President on September 16, 2011; and P.L. 112-91 signed into law by the President on January 31, 2012)……………	**DOE**	***No Revenue Effect***												
PART THREE: THE COMPREHENSIVE 1099 TAXPAYER PROTECTION AND REPAYMENT OF EXCHANGE SUBSIDY OVERPAYMENTS ACT OF 2011 (P.L. 112-9, signed into law by the President on April 14, 2011)														
A. Repeal 1099 Information Reporting Requirements for Certain Payments of More Than $600.....................................	pma 12/31/11	---	-263	-2,785	-1,995	-2,064	-2,135	-2,309	-2,413	-2,523	-2,636	-2,782	---	-21,905
B. Repeal Information Reporting on Rental Property Expense Payments...	pma 12/31/10	[4]	-227	-239	-251	-261	-275	-285	-299	-314	-325	-335	---	-2,811
C. Change Limitations on Amounts Required for Repayment on Reconciliation of Advance Premium Assistance Tax Credits Associated With Health Insurance Exchanges ($300 individual, $600 family for households below 200 percent FPL; $750 individual, $1,500 family for households below 300 percent FPL; $1,250 individual, $2,500 family for households below 400 percent FPL; no limit for 400 percent FPL and above) [5] [6]...	tyea 12/31/13	---	---	---	673	1,601	2,633	3,262	3,830	4,077	4,265	4,542	---	24,882
TOTAL OF PART THREE……………………………………………………………………		**[4]**	**-490**	**-3,024**	**-1,573**	**-724**	**223**	**668**	**1,118**	**1,240**	**1,304**	**1,425**	**---**	**166**
PART FOUR: REVENUE PROVISION OF THE DEPARTMENT OF DEFENSE AND FULL-YEAR CONTINTUING APPROPRIATIONS ACT OF 2011 (P.L. 112-10, signed into law by the President on April 15, 2011)														
A. Free Choice Vouchers [6] [7]..	[8]	---	---	---	29	43	47	61	53	49	61	75	---	418
TOTAL OF PART FOUR……………………………………………………………………		**---**	**---**	**---**	**29**	**43**	**47**	**61**	**53**	**49**	**61**	**75**	**---**	**418**

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
PART FIVE: REVENUE PROVISIONS OF THE TRADE ADJUSTMENT ASSISTANCE EXTENSION ACT OF 2011 (P.L. 112-40, signed into law by the President on October 21, 2011)														
A. Increase HCTC to 72.5 percent; extend other provisions from ARRA; repeal after 2013 [6]...	2/12/11	-9	-71	-70	20	35	35	34	33	32	31	30	---	102
TOTAL OF PART FIVE..		**-9**	**-71**	**-70**	**20**	**35**	**35**	**34**	**33**	**32**	**31**	**30**	**---**	**102**
PART SIX: REVENUE PROVISIONS OF THE UNITED STATES-KOREA FREE TRADE AGREEMENT IMPLEMTATION ACT (P.L. 112-41, signed into law by the President on October 21, 2011)														
A. Earned Income Tax Credit ("EITC") Paid Preparer Penalties..	rrtbfa 12/31/11	---	9	19	19	20	20	21	21	22	23	23	---	197
B. Requirement for Prisons Located in U.S. to Provide Information for Tax Administration...	DOE	---	6	13	13	13	14	14	15	15	16	16	---	134
C. Merchandise Processing Fee [9]...	---	*Estimated by the Congressional Budget Office*												
D. Customs User Fees [9]...	---	*Estimated by the Congressional Budget Office*												
E. Time for Payment of Corporate Estimated Taxes														
1. Increase the amount of any required installment of corporate estimated tax due in July, August, and September 2012 by 0.25 percent for corporations with assets of at least $1 billion..	DOE	---	118	-118	---	---	---	---	---	---	---	---	---	---
2. Increase the amount of any required installment of corporate estimated tax due in July, August, and September 2016 by 2.75 percent for corporations with assets of at least $1 billion..	DOE	---	---	---	---	---	1,894	-1,894	---	---	---	---	---	---
TOTAL OF PART SIX..		**---**	**133**	**-86**	**32**	**33**	**1,928**	**-1,859**	**36**	**37**	**39**	**39**	**---**	**331**
PART SEVEN: REPEAL OF THREE- PERCENT WITHHOLDING ON CERTAIN PAYMENTS MADE TO VENDORS, WORK OPPORTUNITY TAX CREDIT FOR VETERANS, OTHER PROVISIONS RELATED TO FEDERAL VENDORS AND MODIFICATON TO AGI CALCULATION FOR DETERMINING CERTAIN HEALTHCARE PROGROM ELIGIBILITY (P.L. 112-56 signed into law by the President on November 21, 2011)														
A. Repeal of Imposition of Three-Percent Withholding on Certain Payments Made to Vendors by Government Entities...	pma 12/31/11	---	---	-6,065	-546	-576	-600	-627	-653	-681	-709	-738	---	-11,194
B. Returning Heroes and Wounded Warriors Work Opportunity Tax Credits...	wpoifibwa DOE	---	-62	-86	-29	-9	-4	-2	---	---	---	---	---	-193
C. One-Hundred Percent Levy for Payments to Federal Vendors Relating to Property...	lia DOE	---	5	12	14	14	14	15	15	15	15	16	---	135
D. Study and Report on Reducing the Amount of the Tax Gap Owed by Federal Contractors...	[10]	*No Revenue Effect*												

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
E. Modification of Calculation of Modified Adjusted Gross Income for Determining Eligibility for Certain Healthcare Programs [6] [11] [12]	DOE [13]	---	---	---	702	468	1,478	1,825	2,014	2,158	1,786	2,554	---	12,986
TOTAL OF PART SEVEN		**---**	**-57**	**-6,139**	**141**	**-103**	**888**	**1,211**	**1,376**	**1,492**	**1,092**	**1,832**	**---**	**1,734**
PART EIGHT: REVENUE PROVISION CONTAINED IN THE TEMPORARY PAYROLL TAX CUT CONTINUATION ACT OF 2011 (P.L. 112-78, signed into law by the President on December 23, 2011)														
A. Temporarily Extend the 4.2 Percent Social Security Payroll Tax Rate for Individuals (sunset 2/29/12) [14]	rra 12/31/11 & tyba 12/31/11	---	-18,782	-2,032	---	---	---	---	---	---	---	---	---	-20,814
TOTAL OF PART EIGHT		**---**	**-18,782**	**-2,032**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**-20,814**
PART NINE: THE AIRPORT AND AIRWAY TRUST FUND PROVISIONS AND RELATED TAXES IN THE FAA MODERNIZATION AND REFORM ACT OF 2012 (P.L. 112-95, signed into law by the President on February 14, 2012)														
A. Extension of Taxes Funding Airport and Airway Trust Fund (sunset 9/30/15)	2/18/12	*No Revenue Effect*												
B. Extension of Airport and Airway Trust Fund Expenditure Authority (sunset 9/30/15)	2/18/12	*No Revenue Effect*												
C. Treatment of Fractional Ownership Aircraft Program Flights: 14.1 cpg Temporary Fuel Surtax (sunset 9/30/21); Temporary Treatment As Noncommercial Aviation (sunset 9/30/15)	ttpa, uoaa, & fua 3/31/12	---	-6	-23	-26	-28	28	36	37	38	39	41	2	138
D. Transparency In Passenger Tax Disclosures	tpa 3/31/12	*Negligible Revenue Effect*												
E. Tax-Exempt Bond Financing for Fixed-Wing Emergency Medical Aircraft	oia DOE	---	[15]	-1	-1	-2	-2	-3	-3	-4	-5	-5	-6	-32
F. Rollover of Amounts Received in Airline Carrier Bankruptcy (90% Cap and Covered Employee Exception)	[16]	---	-23	-137	-27	-4	-4	-3	-3	-3	-3	-3	-3	-213
G. Termination of Exemption for Small Jet Aircraft on Nonestablished Lines	ttpa 3/31/12	---	1	2	2	2	2	2	2	2	3	3	3	23
H. Modification of Control Definition for Purposes of Section 249	ra DOE	---	4	7	8	8	8	9	9	10	10	11	11	95
TOTAL OF PART NINE		**---**	**-24**	**-152**	**-44**	**-24**	**32**	**41**	**42**	**43**	**44**	**47**	**7**	**11**
PART TEN: REVENUE PROVISIONS CONTAINED IN THE MIDDLE CLASS TAX RELIEF AND JOB CREATION ACT OF 2012 (P.L. 112-96, signed into law by the President on February 22, 2012)														
A. Extension of the Payroll Tax Holiday (sunset 12/31/12) [17]	rra 12/31/11 & tyba 12/31/11	---	-70,133	-23,086	---	---	---	---	---	---	---	---	---	-93,219
B. Repeal of Shifts in the Timing of Corporate Estimated Tax Payments	DOE	---	-235	235	-28,993	-1,196	30,189	---	---	-4,555	4,555	---	---	---
TOTAL OF PART TEN		**---**	**-70,368**	**-22,851**	**-28,993**	**-1,196**	**30,189**	**---**	**---**	**-4,555**	**4,555**	**---**	**---**	**-93,219**

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
PART ELEVEN: REVENUE PROVISION OF THE NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2013 (P.L. 112-239, signed into law by the President on January 2, 2013)														
A. Retention of Definition of Public Safety Officer for Certain Exclusions	[18]	---	---	- - - - No Revenue Effect - - - -										
TOTAL OF PART ELEVEN		---	---	- - - - ***No Revenue Effect*** - - - -										
PART TWELVE: REVENUE PROVISIONS CONTAIN IN THE AMERICAN TAXPAYER RELIEF ACT OF 2012 (P.L. 112-240, signed into law by the President on January 2, 2013)														
I. General Extensions														
A. Permanent Extension of Certain Tax Cuts Enacted in 2001														
1. Individual income tax rate relief:														
a. Retain 10% income tax bracket [6]	tyba 12/31/12	---	---	-30,723	-44,168	-44,841	-45,604	-45,986	-46,049	-46,360	-46,518	-46,412	-45,980	-442,641
b. Retain the 25% and 28% income tax brackets	tyba 12/31/12	---	---	-12,731	-18,507	-19,549	-20,839	-21,972	-22,849	-23,447	-23,916	-24,198	-24,226	-212,234
c. Retain the 33% income tax bracket, and retain 35% bracket only for taxable income under $400,000 ($450,000 joint) [19]	tyba 12/31/12	---	---	-5,094	-7,595	-8,334	-9,332	-10,412	-11,466	-12,386	-13,352	-14,271	-15,235	-107,477
2. Raise the threshold for the overall limitation on itemized deductions and the personal exemption phaseout to AGI above $250,000 ($300,000 joint) [20]	tyba 12/31/12	---	---	-392	-802	-867	-955	-1,043	-1,131	-1,212	-1,292	-1,371	-1,449	-10,514
3. Retain the child tax credit at $1,000; refundable up to greater of 15% of earned income in excess of $10,000 (indexed from 2001) or the taxpayer's social security tax liability to the extent that it exceeds the taxpayer's earned income credit; allow credit against the AMT; repeal AMT offset of refundable credits [6]	tyba 12/31/12	---	---	-4,117	-35,825	-36,785	-37,749	-38,674	-39,310	-39,869	-40,262	-40,714	-41,189	-354,493
4. Marriage penalty relief:														
a. Standard deduction and 15% rate bracket set at 2 times single for married filing jointly [6]	tyba 12/31/12	---	---	-4,279	-6,168	-6,134	-6,067	-5,926	-5,689	-5,508	-5,353	-5,298	-5,182	-55,604
b. EITC modification and simplification - increase in joint returns beginning and ending income level for phaseout by $3,000 indexed after 2008; simplify definition of earned income; use AGI instead of modified AGI; simplify definition of qualifying child and tie-breaker rules; and allow math error procedure with Federal Case registry data beginning in 2004 [6]	tyba 12/31/12	---	---	-31	-3,126	-3,100	-3,115	-3,086	-3,120	-3,193	-3,284	-3,407	-3,565	-29,026

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
5. Education Tax Relief:														
a. Coverdell Education Savings Accounts ("ESAs") - increase the annual contribution limit to $2,000; allow ESA contributions for special needs beneficiaries above the age of 18; allow corporations and other entities to contribute to ESAs; allow contributions until April 15 of the following year; allow a taxpayer to exclude ESA distributions from gross income and claim the HOPE or Lifetime Learning credits as long as they are not used for the same expenses; repeal excise tax on contributions made to ESA when contribution made by anyone on behalf of same beneficiary to QTP; modify phaseout range for married taxpayers; allow tax-free expenditures for elementary and secondary school expenses; expand the definition of qualified expenses to include certain computers and related items...	tyba 12/31/12	---	---	-9	-14	-16	-19	-23	-28	-33	-38	-43	-48	-271
b. Employer provided educational assistance - extend the exclusion for undergraduate courses and graduate level courses [21]...	cba 12/31/12	---	---	-230	-1,153	-1,176	-1,200	-1,224	-1,248	-1,273	-1,299	-1,325	-1,351	-11,477
c. Student loan interest deduction - eliminate the 60-month rule and the disallowance for voluntary payments; increase phaseout ranges to $50,000-$65,000 single/$100,000- $130,000 joint, indexed for inflation...	ipa 12/31/12	---	---	-89	-898	-1,005	-1,024	-1,067	-1,025	-1,118	-1,098	-1,174	-1,180	-9,676
d. Eliminate the tax on awards under the National Health Service Corps Scholarship program and F. Edward Herbert Armed Forces Health Professions Scholarship and Financial Assistance Program......................................	tyba 12/31/12	---	---	-127	-132	-136	-141	-147	-152	-158	-163	-169	-176	-1,501
e. Increase arbitrage rebate exception for governmental bonds used to finance qualified school construction from $10 million to $15 million...	bia 12/31/12	---	---	[15]	-1	-2	-4	-6	-8	-10	-12	-14	-16	-72
f. Issuance of tax-exempt private activity bonds for qualified education facilities with annual State volume caps the greater of $10 per resident or $5 million...............	bia 12/31/12	---	---	[15]	-2	-5	-8	-12	-16	-21	-25	-29	-34	-152
6. Other incentives for families and children:														
a. Dependent care tax credit - increase the credit rate to 35%, increase the eligible expenses to $3,000 for one child and $6,000 for two or more children (not indexed), and increase the start of the phase-out to $15,000 of AGI [6]....	tyba 12/31/12	---	---	-62	-246	-233	-222	-208	-190	-175	-164	-154	-139	-1,791
b. Adoption credit - increase the expense limit and the exclusion to $10,000 for both non-special needs and special needs adoptions, make the credit independent of expenses for special needs adoptions, extend the credit and the exclusion, increase the phase-out start point to $150,000, index for inflation the expenses limit and the phase-out start point for both the credit and the exclusion, and allow the credit to apply to the AMT [6]......................	tyba 12/31/12	---	---	-154	-520	-539	-555	-577	-606	-630	-643	-664	-693	-5,580
c. Employer-provided child care credit of 25% for childcare expenditures and 10% for child care resource.....................	tyba 12/31/12	---	---	-14	-17	-19	-21	-22	-22	-23	-23	-24	-24	-209
7. Allow electing Alaska Native Settlement Trusts to tax income to the Trust not the beneficiaries.................................	tyba 12/31/12	---	---	-2	-5	-5	-4	-5	-5	-5	-5	-5	-5	-46

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
8. Permanently extend current estate and gift tax policy ($5 million indexed and unified exemption amount with portability) but with a top tax rate of 40%...............................	dda & gma 12/31/12	---	---	-334	-27,482	-31,915	-34,815	-37,964	-40,946	-44,033	-47,187	-50,406	-53,986	-369,068
B. Permanent Extension of Certain Tax Cuts Enacted in 2003														
1. Tax capital gains with a 0%/15%/20% rate structure..............	tyba 12/31/12	---	---	-700	-4,904	-6,282	-6,480	-6,584	-6,532	-6,558	-6,748	-6,914	-7,160	-58,863
2. Tax dividends with a 0%/15%/20% rate structure...................	tyba 12/31/12	---	---	-6,038	-18,150	-20,195	-21,705	-23,961	-25,876	-27,165	-28,211	-29,380	-30,375	-231,057
C. Extension of Certain Tax Cuts Enacted in 2009														
1. Extension of American opportunity tax credit (sunset 12/31/17) [6]..	tyba 12/31/12	---	---	-2,625	-13,135	-13,238	-13,498	-13,717	-11,067	---	---	---	---	-67,280
2. Reduce the earnings threshold for the refundable portion of the child tax credit to $3,000 (sunset 12/31/17) [6].............	tyba 12/31/12	---	---	-7	-10,680	-10,451	-10,166	-9,696	-9,518	---	---	---	---	-50,518
3. Extension of modification of the earned income tax credit:														
a. Extend the earned income tax credit for larger families (sunset 12/31/17) [6]..	tyba 12/31/12	---	---	-18	-1,773	-1,736	-1,688	-1,629	-1,624	---	---	---	---	-8,467
b. EITC modification and simplification - increase in joint returns beginning and ending income level for phaseout by $5,000 indexed after 2008 (sunset 12/31/17) [6]...........	tyba 12/31/12	---	---	-16	-1,639	-1,612	-1,596	-1,564	-1,552	---	---	---	---	-7,979
4. Refunds disregarded in the administration of Federal programs and federally assisted programs [6]..........................	ara 12/31/12	---	---- *Estimated by the Congressional Budget Office* -												
D. Permanent Alternative Minimum Tax Relief - increase the AMT exemption amount to $50,600 ($78,750 joint) in 2012 and index the AMT exemption amount, exemption phaseout threshold, and income bracket beginning in 2013..	tyba 12/31/11	---	---	-138,750	-105,375	-119,550	-136,395	-155,947	-179,805	-204,990	-229,846	-257,451	-287,491	-1,815,600
II. Individual Tax Extenders														
1. Above-the-line deduction of up to $250 for teacher classroom expenses (sunset 12/31/13).....................................	tyba 12/31/11	---	---	-242	-164	---	---	---	---	---	---	---	---	-406
2. Discharge of indebtedness on principal residence excluded from gross income of individuals (sunset 12/31/13)................	doioa 12/31/12	---	---	-199	-1,128	---	---	---	---	---	---	---	---	-1,327
3. Parity for exclusion for employer-provided mass transit and parking benefits (sunset 12/31/13) [22]............................	ma 12/31/11	---	---	-190	-30	---	---	---	---	---	---	---	---	-220
4. Premiums for mortgage insurance deductible as interest that is qualified residence interest (sunset 12/31/13)................	apoaa 12/31/11	---	---	-791	-506	---	---	---	---	---	---	---	---	-1,297
5. Deduction for State and local general sales taxes (sunset 12/31/13)..	tyba 12/31/11	---	---	-2,859	-2,404	-275	---	---	---	---	---	---	---	-5,538
6. Contributions of capital gain real property made for qualified conservation purposes (sunset 12/31/13)..................	cmi tyba 12/31/11	---	---	-82	-50	-11	-2	-7	-20	-26	-21	-19	-17	-254
7. Deduction for qualified tuition and related expenses (sunset 12/31/13)..	tyba 12/31/11	---	---	-944	-762	---	---	---	---	---	---	---	---	-1,706
8. Tax-free distributions from IRAs to certain public charities for individuals age 70-1/2 or older, not to exceed $100,000 per taxpayer per year; special transition rules for certain distributions made in December 2012 and January 2013 (sunset 12/31/13)..	dmi tyba 12/31/11	---	---	-594	-283	-41	-43	-46	-49	-51	-55	-58	-61	-1,280
9. Modify and make permanent the authority for disclosure of prisoner return information to certain prison officials.........	DOE	---	---	[23]	1	1	1	1	1	1	1	1	1	12
III. Business Tax Extenders														
1. Extend and modify tax credit for research and experimentation expenses (sunset 12/31/13)...........................	apoia 12/31/11	---	---	-6,232	-1,989	-1,077	-947	-834	-736	-670	-638	-617	-584	-14,324
2. Create a LIHC rate floor of 9 percent (sunset 12/31/13)..........	amb 1/1/14	---	---	---	-1	-1	-1	-1	-1	-1	-1	-1	-1	-8

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
3. LIHTC treatment of military housing allowances (sunset 12/31/13)..	da 12/31/11	---	---	-2	-3	-4	-4	-4	-4	-4	-4	-4	-4	-37
4. Indian employment tax credit (sunset 12/31/13)......................	tyba 12/31/11	---	---	-69	-38	-11	-1	---	---	---	---	---	---	-119
5. New markets tax credit ($3.5 billion allocation in 2012 and 2013) (sunset 12/31/13)..	cyba 12/31/11	---	---	-5	-27	-90	-171	-221	-252	-279	-288	-267	-194	-1,794
6. 50% tax credit for certain expenditures for maintaining railroad tracks (sunset 12/31/13)...	apoia 12/31/11	---	---	-232	-99	[15]	---	---	---	---	---	---	---	-331
7. Mine rescue team training credit (sunset 12/31/13)..................	tyba 12/31/11	---	---	-1	-2	-1	[15]	[15]	[15]	----	---	---	---	-5
8. Employer wage credit for activated military reservists (sunset 12/31/13)..	pma 12/31/11	---	---	-3	-3	-1	[15]	---	---	---	---	---	---	-7
9. Work opportunity tax credit:														
a. Work opportunity tax credit (sunset 12/31/13)....................	wpoifibwa 12/31/11	---	---	-894	-533	-199	-84	-45	-17	-2	---	---	---	-1,773
b. Work opportunity tax credit for qualified veterans (sunset 12/31/13)..	wpoifibwa 12/31/12	---	---	-53	-40	-20	-6	-4	-2	[15]	---	---	---	-125
10. Qualified zone academy bonds ($400 million allocation in 2012 and in 2013) (sunset 12/31/13).......................................	oia 12/31/11	---	---	-3	-8	-16	-24	-29	-31	-31	-31	-31	-31	-235
11. 15-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements (sunset 12/31/13)............	ppisa 12/31/11	---	---	-277	-371	-416	-411	-401	-388	-383	-378	-361	-331	-3,717
12. 7-year recovery period for certain motorsports racing track facilities (sunset 12/31/13)...	ppisa 12/31/11	---	---	-46	-24	-14	-7	-4	-5	-3	5	10	10	-78
13. Accelerated depreciation for business property on Indian reservations (sunset 12/31/13)..	ppisa 12/31/11	---	---	-310	-273	-77	50	111	138	102	46	1	-11	-222
14. Enhanced charitable deduction for contributions of food inventory (sunset 12/31/13)...	cma 12/31/11	---	---	-218	-96	---	---	---	---	---	---	---	---	-314
15. Increase in section 179 expensing amounts and threshold limits $500,000/$2,000,000 (sunset 12/31/13) [24]..................	tyba 12/31/11	---	---	-8,088	-4,042	3,129	2,022	1,526	1,191	777	500	350	283	-2,352
16. Election to expense mine safety equipment (sunset 12/31/13)..	ppisa 12/31/11	---	---	-27	1	7	5	4	4	3	2	1	---	---
17. Special expensing rules for certain film and television productions (sunset 12/31/13)..	qfatpca 12/31/11	---	---	-266	-164	45	38	32	24	16	11	9	7	-248
18. Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sunset 12/31/13)..	tyba 12/31/11	---	---	-236	-122	---	---	---	---	---	---	---	---	-358
19. Modify tax treatment of certain payments under existing arrangements to controlling exempt organizations (sunset 12/31/13)..	proaa 12/31/11	---	---	-35	-5	---	---	---	---	---	---	---	---	-40
20. Treatment of certain dividends of RICs (sunset 12/31/13)..	[25]	---	---	-124	-27	---	---	---	---	---	---	---	---	-151
21. Extend the treatment of RICs as "qualified investment entities" under section 897 (FIRPTA) (sunset 12/31/13)..........	1/1/12	---	---	-48	-12	---	---	---	---	---	---	---	---	-60
22. Exception under subpart F for active financing income (sunset 12/31/13)..	tyba 12/31/11	---	---	-9,399	-1,826	---	---	---	---	---	---	---	---	-11,225
23. Look-through treatment of payments between related CFCs under foreign personal holding company income rules (sunset 12/31/13)...	tyba 12/31/11	---	---	-1,199	-304	---	---	---	---	---	---	---	---	-1,503
24. Special rules applicable to qualified small business stock (sunset 12/31/13)..	saa 12/31/11	---	---	6	7	---	---	-15	-212	-694	-27	-10	-9	-954
25. Basis adjustment to stock of S corporations making charitable contributions of property (sunset 12/31/13).............	cmi tyba 12/31/11	---	---	-93	-51	-10	-11	-10	-10	-10	-10	-10	-10	-225

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
26. Reduction in recognition period for S corporation built-in gains tax (sunset 12/31/13)	tyba 12/31/11	---	---	-180	-76	1	1	1	1	1	1	1	---	-250
27. Empowerment zone tax incentives (sunset 12/31/13)	tyba 12/31/11	---	---	-360	-44	-23	-11	-5	-1	-1	-2	-2	-2	-450
28. New York Liberty Zone tax-exempt bond financing (sunset 12/31/13)	bia 12/31/11	---	---					*No Revenue Effect*						
29. Temporary increase in limit on cover over of rum excise tax revenues (from $10.50 to $13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sunset 12/31/13) [6] [26]	abiUSa 12/31/11	---	---	-199	-23	---	---	---	---	---	---	---	---	-222
30. Extension and modification of economic development credit for American Samoa (sunset 12/31/13)	tyba 12/31/11	---	---	-38	-24	---	---	---	---	---	---	---	---	-62
31. Extension and modification of bonus depreciation:														
a. 50% bonus depreciation (sunset 12/31/13)	[27]	---	---	-34,439	-15,838	15,018	10,101	7,515	5,707	3,446	1,970	1,111	737	-4,673
b. Election to accelerate AMT credit in lieu of bonus depreciation (sunset 12/31/13)	[27]	---	---	-162	-139	-26	4	6	7	7	7	7	7	-283
IV. Energy Tax Extenders														
1. Extension and modification of section 25C nonbusiness energy property (sunset 12/31/13)	ppisa 12/31/11	---	---	-1,456	-991	---	---	---	---	---	---	---	---	-2,446
2. Alternative fuel vehicle refueling property (non- hydrogen refueling property) (sunset 12/31/13)	ppisa 12/31/11	---	---	-34	-9	-1	[15]	[23]	[23]	[23]	[23]	[23]	[23]	-44
3. Expand section 30D credit for qualified plug-in electric drive motor vehicles to include electric motorcycles (sunset 12/31/13)	vaa 12/31/11	---	---	-1	-3	-3	---	---	---	---	---	---	---	-7
4. Credit for production of cellulosic biofuel with a maximum credit of $1.01 per gallon and inclusion of fuel from algae (sunset 12/31/13)	fsoua DOE [28]	---	---	-43	-16	---	---	---	---	---	---	---	---	-59
5. Extension of credits for biodiesel and renewable diesel:														
a. Income tax credits for biodiesel fuel, biodiesel used to produce a qualified mixture, and small agri-biodiesel producers (sunset 12/31/13)	fsoua 12/31/11	---	---	-1,881	-300	---	---	---	---	---	---	---	---	-2,181
b. Income tax credits for renewable diesel fuel and renewable diesel used to produce a qualified mixture (sunset 12/31/13)	fsoua 12/31/11	---	---					*Estimate Included In Item 5.a.*						
c. Excise tax credits and outlay payments for biodiesel fuel mixtures (sunset 12/31/13)	fsoua 12/31/11	---	---					*Estimate Included In Item 5.a.*						
d. Excise tax credits and outlay payments for renewable diesel fuel mixtures (sunset 12/31/13)	fsoua 12/31/11	---	---					*Estimate Included In Item 5.a.*						
6. Credit for production of Indian coal (sunset 12/31/13)	cpa 12/31/12	---	---	-1	[15]	[15]	[15]	[15]	[15]	[15]	---	---	---	-1
7. Extension and modification of credits for renewable energy:														
a. Modify expiration date for renewable electricity production credit to construction beginning before December 31, 2013	DOE	---	---	-116	-445	-882	-1,230	-1,386	-1,499	-1,568	-1,642	-1,686	-1,729	-12,184
b. Exclude segregated paper which is commonly recycled from the definition of municipal solid waste for purposes of the section 45 credit for renewable electricity production	DOE	---	---	6	7	8	8	8	9	9	10	10	---	75
c. Election to claim the energy credit in lieu of the electricity production credit (sunset 12/31/13)	DOE	---	---	---	-100	-130	-54	-10	7	28	40	42	43	-135

Provision	Effective	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
8. Credit for construction of energy-efficient new homes (sunset 12/31/13).......	haa 12/31/11	---	---	-74	-27	-14	-12	-11	-9	-6	-1	---	---	-154
9. Credit for energy-efficient appliances (sunset 12/31/13).........	apa 12/31/11	---	---	-155	-82	-65	-65	-65	-65	-65	-54	-28	-6	-650
10. Special depreciation allowance for cellulosic biofuel plant property and inclusion of algae-based fuel plant property (sunset 12/31/13).......	ppisa 12/31/12 [29]	---	---	-1	-2	[23]	[23]	[23]	[23]	[23]	[23]	[23]	[23]	[15]
11. Special rule for sales or dispositions to implement Federal Energy Regulatory Commission ("FERC") or State electric restructuring policy (sunset 12/31/13).......	tyba 12/31/11	---	---	-596	-48	110	110	110	110	110	95	---	---	---
12. Excise tax credits and outlay payments for alternative fuel, and excise tax credits for alternative fuel mixtures (sunset 12/31/13) (other than liquefied hydrogen).......	fsoua 12/31/11	---	---	-305	-56	---	---	---	---	---	---	---	---	-360
X. Budget Provision														
1. Amounts in applicable retirement plans may be transferred to designated Roth accounts without distribution.......	[30]	---	---	293	784	914	1,058	1,229	1,405	1,526	1,593	1,661	1,723	12,186
TOTAL OF PART TWELVE		**---**	**---**	**-280,039**	**-335,127**	**-311,900**	**-342,888**	**-374,007**	**-404,531**	**-415,935**	**-448,310**	**-483,313**	**-519,683**	**-3,915,717**
PART THIRTEEN: CUSTOMS USER FEES AND CORPORATE ESTIMATED TAXES [31]														
A. Extension of Customs User Fees [9] (P.L. 112-40, signed into law by the President on October 21, 2011).......	---	*Estimated by the Congressional Budget Office*												
B. Time for Payment of Corporate Estimated Taxes														
1. Increase the amount of any required installment of corporate estimated tax otherwise due in July, August, and September 2016 by 0.5 percent for corporations with assets of at least $1 billion (P.L. 112-42, signed into law by the President on October 21, 2011).......	DOE	---	---	---	---	---	344	-344	---	---	---	---	---	---
2. Increase the amount of any required installment of corporate estimated tax otherwise due in July, August, and September 2012 by 0.25 percent for corporations with assets of at least $1 billion (P.L. 112-43, signed into law by the President on October 21, 2011).......	DOE	---	118	-118	---	---	---	---	---	---	---	---	---	---
3. Increase the amount of any required installment of corporate estimated tax otherwise due in July, August, and September 2016 by 0.25 percent for corporations with assets of at least $1 billion (P.L. 112-43, signed into law by the President on October 21, 2011).......	DOE	---	---	---	---	---	172	-172	---	---	---	---	---	---
4. Increase the amount of any required installment of corporate estimated tax otherwise due in July, August, and September 2017 by 0.25 percent for corporations with assets of at least $1 billion (P.L. 112-163, signed into law by the President on August 10, 2012).......	DOE	---	---	---	---	---	---	196	-196	---	---	---	---	---
TOTAL OF PART THIRTEEN		**---**	**118**	**-118**	**---**	**---**	**516**	**-320**	**-196**	**---**	**---**	**---**	**---**	**---**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

[Legend and Footnotes for the Appendix appear on the following pages]

Legend and Footnotes for the Appendix:

Legend for "Effective" column:

ara = articles removed after
DOE = date of enactment
abiUSa = articles brought into the United States after
amb = allocations made before
apa = appliances purchased after
apoaa = amounts paid or accrued after
apoia = amounts paid or incurred after
ara = amounts received after
bia = bonds issued after
cba = courses beginning after
cma = contributions made after
cmi = contributions made in
cpa = coal produced after
pyba = plan years beginning after
fua = fuel used after

cyba = calendar years beginning after
da = distributions after
dmi = distributions made in
DOE = date of enactment
doioa = discharge of indebtedness occurring after
fsoua = fuel sold or used after
haa = homes acquired after
ipa = interest paid after
lia= levies issued after
ma = months after
oia = obligations issued after
pma = payments made after
ppisa = property placed in service after
proaa = payments received or accrued after

qfatpca = qualified film and television productions commencing after
ra = repurchases after
rra = remuneration received after
rrtbfa = returns required to be filed after
saa = stock acquired after
tma = transfers made after
tpa = transportation provided after
ttpa = taxable transportation provided after
tyba = taxable years beginning after
tyea = taxable years ending after
uoaa = uses of aircraft after
vaa = vehicles acquired after
wpoifibwa = wages paid or incurred for individuals beginning work after

[1] The annual heavy vehicle use tax sunsets October 1, 2017.

[2] Estimate includes the following budget effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
Total Change	---	595	2,391	4,576	5,144	3,765	1,671	274	-807	-2,328	-3,121	-2,766	9,394
Revenue (on-budget)	---	595	2,277	4,288	4,832	3,368	1,365	84	-782	-2,056	-2,769	-2,386	8,817
OASDI (off-budget)	---	---	114	213	212	172	81	-10	-100	-247	-277	-230	-73
Direct Spending Effects [3]	---	---	---	75	100	225	225	200	75	-25	-75	-150	650

[3] Estimate provided by the Congressional Budget office.

[4] Negligible revenue effect.

[5] Estimate includes the following off-budget effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
effects	---	---	---	-89	-211	-371	-438	-468	-483	-501	-521	---	-3,082

[6] Estimate includes the following outlay effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
Change limitations on amounts required for repayment on reconciliation of advance premium assistance tax credits associated with health insurance exchanges	---	---	---	-566	-1,314	-2,198	-2,661	-3,048	-3,207	-3,350	-3,547	---	-19,891
Free Choice Vouchers	---	---	---	-7	-9	-12	-12	-7	-7	-14	-13	---	-80
Increase HCTC to 72.5 percent; extend other provisions from ARRA; repeal after 2013	7	56	55	-16	-28	-28	-27	-26	-26	-25	-24	---	-81
Modification of Calculation of Modified Adjusted Gross Income for Determining Eligibility for Certain Healthcare Programs	---	---	---	-1,120	-1,467	-2,644	-2,868	-3,087	-3,372	-3,333	-3,805	---	-21,698
Retain 10% bracket	---	---	---	1,682	2,927	3,674	4,568	4,644	4,865	4,869	4,849	4,806	36,884
Retain the child tax credit at $1,000; refundable; AMT rules	---	---	---	15,048	15,056	15,042	14,832	14,859	14,887	14,813	14,879	14,941	134,357
Marriage penalty relief - standard deduction and 15% rate	---	---	---	159	228	255	306	309	318	322	308	317	2,522
EITC modification and simplification ($3,000)	---	---	---	2,541	2,509	2,493	2,437	2,444	2,486	2,507	2,565	2,593	22,574
Dependent care tax credit	---	---	---	43	171	165	160	150	139	131	123	117	1,199
Adoption credit	---	---	---	88	87	85	85	88	82	81	80	83	759
American opportunity tax credit	---	---	---	3,191	2,929	2,848	2,677	2,512	---	---	---	---	14,157
Reduce the earnings threshold for the refundable portion of the child tax credit to $3,000	---	---	---	10,645	10,410	10,123	9,651	9,480	---	---	---	---	50,309
Extend EITC for larger families	---	---	---	1,611	1,559	1,495	1,422	1,395	---	---	---	---	7,483
EITC modification and simplification ($5,000)	---	---	---	1,305	1,276	1,261	1,224	1,225	---	---	---	---	6,290
Refunds disregarded in the administration of Federal programs and federally assisted programs	---	---	*Estimated by the Congressional Budget Office*										
Temporary increase in limit on cover over of rum excise tax revenues [26]	---	---	199	23	---	---	---	---	---	---	---	---	222

[Footnotes for the Appendix are continued on the following page]

Footnotes for the Appendix continued:

[7] Estimate includes the following effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
Total Revenue Effects…………	---	---	---	29	43	47	61	53	49	61	75	---	418
On-budget effects…………	---	---	---	19	29	32	41	35	32	42	52	---	282
Off-budget effects…………	---	---	---	10	15	15	20	18	16	19	24	---	136

[8] Effective as if included in the related provisions of, and amendments made by, the Patient Protection and Affordable Care Act (P.L. 111-148).

[9] For the details relating to provision, see Part Six of the General Explanation. For the estimates relating to this provision, see the Congressional Budget Office website, www.CBO.gov.

[10] The study shall be submitted not later than 12 months after the date enactment.

[11] Estimate provided by the staff of the Joint Committee on Taxation and the Congressional Budget Office.

[12] Estimate includes the following effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
Off-budget effects…………	---	---	---	186	226	201	130	183	218	303	152	---	1,598

[13] The provision affects statutes that become effective for taxable years ending after December 31, 2013.

[14] Estimate includes the following effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
Total Revenue Effects…………	---	-18,782	-2,032	---	---	---	---	---	---	---	---	---	-20,814
On-budget effects…………	---	136	70	---	---	---	---	---	---	---	---	---	206
Off-budget effects…………	---	-18,918	-2,102	---	---	---	---	---	---	---	---	---	-21,020

[15] Loss of less than $500,000.

[16] Effective for transfers made after the date of enactment with respect to airline payment amounts paid before, on, or after such date.

[17] Estimate includes the following effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
Total Revenue Effects…………	---	-70,133	-23,086	---	---	---	---	---	---	---	---	---	-93,219
On-budget effects…………	---	748	541	---	---	---	---	---	---	---	---	---	1,289
Off-budget effects…………	---	-70,881	-23,627	---	---	---	---	---	---	---	---	---	-94,508

[18] Effective when the related amendment to the definition of public safety officer in the Omnibus Crime Control and Safe Streets Act of 1968 takes effect.

[19] For head of household filers, the 35% bracket is extended to taxable income under $425,000.

[20] For head of household filers, the repeal of the overall limitation on itemized deduction and the personal exemption phase out applies for AGI under $275,000.

[21] Estimates includes the following budget effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
Total Revenue Effects…………	---	---	-230	-1,153	-1,176	-1,200	-1,224	-1,248	-1,273	-1,299	-1,325	-1,351	-11,477
On-budget effects…………	---	---	-153	-769	-784	-800	-816	-832	-849	-866	-883	-901	-7,652
Off-budget effects…………	---	---	-77	-384	-392	-400	-408	-416	-424	-433	-442	-450	-3,826

[22] Estimate includes the following effects:

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22
General Fund…………	---	---	-127	-20	---	---	---	---	---	---	---	---	-148
OASDI…………	---	---	-63	-10	---	---	---	---	---	---	---	---	-72

[23] Gain of less than $500,000.

[24] Estimate includes expensing for qualified real property.

[25] Effective for dividends with respect to taxable years of regulated investment companies beginning after December 31, 2011.

[26] Estimate provided by the Congressional Budget Office.

[27] Effective for property placed in service after December 31, 2012, in taxable years ending after such date.

[28] The technical correction is effective as if included in section 15321(b) of the Heartland, Habitat, Harvest and Horticulture Act of 2008.

[29] Inclusion of algae-based property effective for property placed in service after date of enactment.

[30] Effective for transfers after December 31, 2012, in taxable years ending after such date.

[31] Not elsewhere included.