DESCRIPTION OF REVENUE PROVISIONS FOR H.R. 5260 (UNEMPLOYMENT COMPENSATION AMENDMENTS OF 1992)

Scheduled for a Markup

by the

SENATE COMMITTEE ON FINANCE

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Prepared by the Staff

of the

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of revenue-raising provisions for Senate Committee on Finance markup of H.R. 5260 (Unemployment Compensation Amendments of 1992). The Finance Committee markup is scheduled for June 11, 1992.

H.R. 5260 was passed by the House of Representatives on June 9, 1992.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Revenue Provisions for H.R. 5260 (Unemployment Compensation Amendments of 1992) (JCX-21-92), June 10, 1992.

DESCRIPTION OF REVENUE PROVISIONS FOR H.R. 5260

1. Taxable Year Election for Partnerships, S Corporations, and Personal Service Corporations

Present Law

A partnership is generally required for Federal income tax purposes to use the taxable year that is used by a majority of its partners. An S corporation is generally required for Federal income tax purposes to use the calendar year as its taxable year. A personal service corporation also is generally required for Federal income tax purposes to use the calendar year as its taxable year.[2]

A partnership, S corporation, or personal service corporation, however, may elect to use a taxable year other than the required taxable year. In the case of a partnership, S corporation, or personal service corporation that is adopting a taxable year or changing a taxable year, the taxable year that may be elected generally may not result in a deferral period of more than three months. For this purpose, the deferral period generally is the number of months between (1) the beginning of the taxable year of the partnership, S corporation, or personal service corporation, and (2) the close of the first required taxable year that ends within such year.

A partnership or S corporation that elects a taxable year other than the required taxable year is required to make a payment to the Internal Revenue Service (a "required payment") that is designed to compensate the Federal government for the deferral of tax that results from the use of a taxable year other than the required taxable year. A personal service corporation that elects a taxable year other than the required taxable year is required to satisfy a minimum distribution requirement that applies to certain amounts paid by the personal service corporation to employee-owners.

Description of Proposal

A partnership, S corporation, or personal service corporation would be allowed to elect any taxable year

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[2] For this purpose, a personal service corporation is defined as a C corporation the principal activity of which is the performance of services if (1) the services are substantially performed by employee-owners, and (2) more than 10 percent of the stock of the corporation is owned by employee-owners.

without regard to the length of the deferral period of the taxable year elected if the annual financial statements (if any) of the entity used for credit purposes or provided to the partners, shareholders, or other proprietors of the entity cover the same period as the taxable year elected.

The proposal would increase the amount of the required payment that must be made by a partnership or S corporation that elects a taxable year other than the required taxable year (including any partnership or S corporation that has an election in effect on the date of enactment of the bill).[3] In addition, the proposal would require an additional required payment for any taxable year that a partnership or S corporation first makes a taxable year election or changes a taxable year election to increase the deferral period.

The proposal would also increase the minimum distribution requirement that must be satisfied by a personal service corporation that elects a taxable year other than the required taxable year (including a personal service corporation that has an election in effect on the date of enactment of the bill).

The proposal was included in H.R. 4210 as passed by the House and Senate.

Effective Date

The proposal would apply to taxable years beginning after December 31, 1991.

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[3] The required payment would be determined by using the highest rate of tax in effect under section 1 of the Code plus 2 percentage points.

2. Rollover and Withholding on Nonperiodic Pension Distributions

Present Law

Distributions from tax-qualified pension plans, qualified annuity plans and tax-sheltered annuities generally are includible in gross income in the year paid or distributed under the rules relating to the taxation of annuities. A total or partial distribution of the balance to the credit of an employee under a qualified plan, a qualified annuity plan, or a tax-sheltered annuity may, under certain circumstances, be rolled over tax free to another plan, or annuity or to an individual retirement arrangement (IRA). A rollover of a partial distribution is permitted if (1) the distribution equals at least 50 percent of the balance to the credit of the employee, (2) the distribution is not one of a series of periodic payments, (3) the distribution is made on account of death, disability, or separation from service, and (4) the employee elects rollover treatment. Minimum required distributions and after-tax employee contributions may not be rolled over.

Withholding on pension distributions is not required if the payee elects not to have withholding apply. If no election is made, tax is withheld from nonperiodic payments at a 10-percent rate, unless the payments are part of a qualified total distribution, in which case tables published by the Internal Revenue Service are used to determine the withholding rate. A qualified total distribution generally is a payment within one year of the entire interest in a plan.

Description of Proposal

Under the proposal, any portion of a distribution from a qualified pension or annuity plan or a tax-sheltered annuity (other than a minimum required distribution) could be rolled over tax free to an IRA or another qualified plan or annuity, unless the distribution is part of a series of substantially equal payments made (1) over the life (or life expectancy) of the participant or the joint lives (or joint life expectancies) of the participant and his or her beneficiary, or (2) over a specified period of 10 years of more.

In addition, a qualified plan or annuity or tax-sheltered annuity would be required to permit participants to elect to have any distribution that is eligible for rollover treatment transferred directly to an eligible transferee plan specified by the participant.

Under the proposal, withholding would be imposed at a rate of 20 percent on any distribution that is eligible to be rolled over but that is not transferred directly to an

eligible transferee plan. Payees could not elect to forego withholding.

A similar proposal was included in H.R. 4210, except that that provision does not change the withholding rules.

Effective Date

The proposal would be effective for years beginning after December 31, 1992.

3. Modify Estimated Tax Payment Rules for Large Corporations

Present Law

A corporation is subject to an addition to tax for any underpayment of estimated tax. For taxable years beginning in 1993, 1994, 1995, and 1996, a corporation does not have an underpayment of estimated tax if it makes four equal timely estimated tax payments that total at least 95 percent of the tax liability shown on the return for the current taxable year. In addition, a corporation may annualize its taxable income and make estimated tax payments based on 95 percent of the tax liability attributable to such annualized income.

For taxable years beginning in 1992, the 95-percent requirement is a 93-percent requirement; the 95-percent requirement becomes a 90-percent requirement for taxable years beginning in 1997 and thereafter.

A corporation that is not a "large corporation" generally may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25 percent of the tax liability shown on its return for the preceding taxable year (the "100 percent of last year's liability safe harbor"). A large corporation may use this rule with respect to its estimated tax payment for the first quarter of its current taxable year. A large corporation is one that had taxable income of $1 million or more for any of the three preceding taxable years.

Description of Proposal

For taxable years beginning after June 30, 1992, and before 1997, a corporation would be required to base its estimated tax payments on 96 percent (rather than 93 or 95 percent) of its current year tax liability, whether such liability is determined on an actual or annualized basis. For taxable years beginning after 1996, a corporation would be required to base its estimated tax payments on 91 percent (rather than 90 percent) of its current year tax liability.

The proposal would not change the present-law availability of the 100 percent of last year's liability safe harbor for large or small corporations.

A similar proposal was included in H.R. 4210 as passed by the House and Senate.

Effective Date

The proposal would be effective for estimated tax payments applicable to taxable years beginning after June 30, 1992.

4. Mark-to-Market Accounting Method for Dealers in Securities

Present Law

A taxpayer that is a dealer in securities is required for Federal income tax purposes to maintain an inventory of securities held for sale to customers. A dealer in securities is allowed for Federal income tax purposes to determine (or value) the inventory of securities held for sale based on: (1) the cost of the securities; (2) the lower of the cost or market value of the securities; or (3) the market value of the securities.

If the inventory of securities is determined based on cost, unrealized gains and losses with respect to the securities are not taken into account for Federal income tax purposes. If the inventory of securities is determined based on the lower of cost or market value, unrealized losses (but not unrealized gains) with respect to the securities are taken into account for Federal income tax purposes. If the inventory of securities is determined based on market value, both unrealized gains and losses with respect to the securities are taken into account for Federal income tax purposes.

For financial accounting purposes, the inventory of securities generally is determined based on market value.

Description of Proposal

In general

Two general rules (the "mark-to-market rules") would apply to certain securities that are held by a dealer in securities. First, any such security that is inventory in the hands of the dealer would be required to be included in inventory at its fair market value. Second, any such security that is not inventory in the hands of the dealer and that is held as of the close of any taxable year would be treated as sold by the dealer for its fair market value on the last business day of the taxable year and any gain or loss would be required to be taken into account by the dealer in determining gross income for that taxable year.

Definitions

A dealer in securities would be defined as any taxpayer that either (1) regularly purchases securities from, or sells securities to, customers in the ordinary course of a trade or business, or (2) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade

or business.

A security would be defined as: (1) any share of stock in a corporation; (2) any partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; (3) any note, bond, debenture, or other evidence of indebtedness; (4) any interest rate, currency, or equity notional principal contract; and (5) any evidence of an interest in, or any derivative financial instrument in, a security described in (1) through (4) above or any currency, including any option, forward contract, short position, or any similar financial instrument in such a security or currency.

In addition, a security would be defined to include any position if: (1) the position is not a security described in the preceding paragraph; (2) the position is a hedge with respect to a security described in the preceding paragraph; and (3) before the close of the day on which the position was acquired or entered into (or such other time as the Treasury Department may specify in regulations), the position is clearly identified in the dealer's records as a hedge with respect to a security described in the preceding paragraph. A security, however, would not include a contract to which section 1256(a) of the Code applies.

A hedge would be defined as any position that reduces the dealer's risk of interest rate or price changes or currency fluctuations. In addition, any security that is reasonably expected to become a hedge within 60 days after the acquisition of the security would be treated as a hedge.

Exceptions to the mark-to-market rules

Notwithstanding the definition of security, the mark-to-market rules generally would not apply to: (1) any security that is held for investment; (2) any evidence of indebtedness that is acquired (including originated) by a dealer in the ordinary course of a trade or business of the dealer but only if the evidence of indebtedness is not held for sale; (3) any security that is acquired, entered into, or originated by a floor specialist (as defined in section 1236(d) of the Code) in connection with the specialist's duties on the exchange; (4) any security which is a hedge with respect to a security that is not subject to the mark-to-market rules; and (5) any security which is a hedge with respect to a position, right to income, or a liability that is not a security in the hands of the taxpayer. Except as otherwise provided in regulations to be promulgated by the Treasury Department, the exceptions to the mark-to-market rules for certain hedges would not apply to any security that is held by a taxpayer in its capacity as a dealer in such security.

The exceptions to the mark-to-market rules would not apply unless before the close of the day on which the security is acquired, originated, or entered into (or such other time as the Treasury Department may specify in regulations), the security is clearly identified in the dealer's records as being described in one of the exceptions listed in the preceding paragraph.

In addition to clearly identifying a security as qualifying for one of the exceptions to the mark-to-market rules listed above, a dealer would be required to continue to hold the security in a capacity that qualifies the security for one of the exceptions listed above. If at any time after the close of the day on which the security was acquired, originated, or entered into (or such other time as the Treasury Department may specify in regulations), the security is not held in a capacity that qualifies the security for one of the exceptions listed above, then the mark-to-market rules would apply to the security after the date that the security no longer qualifies for one of the exceptions (i.e., only gains and losses attributable to the period that the security no longer qualifies for one of the exceptions would be taken into account under the mark-to-market rules).

Improper identification

If (1) a dealer identifies a security as qualifying for an exception to the mark-to-market rules but the security does not qualify for that exception, or (2) a dealer fails to identify a position that is not a security as a hedge of a security but the position is a hedge of a security, then the mark-to-market rules would apply to any such security or position, except that loss would be recognized under the mark-to-market rules prior to the disposition of the security or position only to the extent of gain previously recognized under the mark-to-market rules (and not previously taken into account under this provision) with respect to the security or position.

Other rules

The uniform cost capitalization rules of section 263A of the Code and the rules of section 263(g) of the Code that require the capitalization of certain interest and carrying charges in the case of straddles would not apply to any security to which the mark-to-market rules apply.

In addition, the Treasury Department would be authorized to promulgate such regulations as may be necessary or appropriate to carry out the proposal, including rules to prevent the use of year-end transfers, related persons, or other arrangements to avoid the proposal.

A similar proposal was included in H.R. 4210 as passed

by the House and Senate.

Effective Date

The proposal would apply to taxable years ending on or after December 31, 1992. A taxpayer that is required to change its method of accounting to comply with the requirements of the proposal would be treated as having initiated the change in method of accounting and as having received the consent of the Treasury Department to make such change.

The net amount of the section 481(a) adjustment would be taken into account ratably over a 10-taxable year period beginning with the first taxable year ending on or after December 31, 1992, to the extent that such amount does not exceed the net amount of the section 481(a) adjustment that would have been determined had the change in method of accounting occurred for the last taxable year beginning before March 20, 1992.

The excess (if any) of (1) the net amount of the section 481(a) adjustment for the first taxable year ending on or after December 31, 1992, over (2) the net amount of the section 481(a) adjustment that would have been determined had the change in method of accounting occurred for the last taxable year beginning before March 20, 1992, would be taken into account ratably over a 4-taxable year period beginning with the first taxable year ending on or after December 31, 1992.

The principles of section 8.03 of Rev. Proc. 92-20, 1992-12 I.R.B. 10, would apply to the section 481(a) adjustment. It is anticipated that section 8.03(1) of Rev. Proc. 92-20 would be applied by taking into account all securities of a dealer that are subject to the mark-to-market rules (including those securities that are not inventory in the hands of the dealer).

No addition to tax would apply to any underpayment of estimated tax that is due before the date of enactment of this proposal to the extent that the underpayment is attributable to the enactment of this proposal.

5. Tax Treatment of Certain FSLIC Financial Assistance

Present Law and Background

A taxpayer may claim a deduction for a loss on the sale or other disposition of property only to the extent that the taxpayer's adjusted basis for the property exceeds the amount realized on the disposition and the loss is not compensated for by insurance or otherwise (sec. 165 of the Code). In the case of a taxpayer on the specific charge-off method of accounting for bad debts, a deduction is allowable for the debt only to the extent that the debt becomes worthless and the taxpayer does not have a reasonable prospect of being reimbursed for the loss. If the taxpayer accounts for bad debts on the reserve method, the worthless portion of a debt is charged against the taxpayer's reserve for bad debts, potentially increasing the taxpayer's deduction for an addition to this reserve.

A special statutory tax rule, enacted in 1981, excluded from a thrift institution's income financial assistance received from the Federal Savings and Loan Insurance Corporation (FSLIC)[4], and prohibited a reduction in the tax basis of the thrift institution's assets on account of the receipt of the assistance. Under the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), taxpayers generally were required to reduce certain tax attributes by one-half the amount of financial assistance received from the FSLIC pursuant to certain acquisitions of financially troubled thrift institutions occurring after December 31, 1988. These special rules were repealed by FIRREA, but still apply to transactions that occurred before May 10, 1989.

Prior to the enactment of FIRREA, the FSLIC entered into a number of assistance agreements in which it agreed to provide loss protection to acquirers of troubled thrift institutions by compensating them for the difference between the book value and sales proceeds of "covered assets." "Covered assets" typically are assets that were classified as nonperforming or troubled at the time of the assisted

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[4] Until it was abolished by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), FSLIC insured the deposits of its member savings and loan associations and was responsible for insolvent member institutions. FIRREA abolished FSLIC and established the FSLIC Resolution Fund (FRF) to assume all of the assets and liabilities of FSLIC (other than those expressly assumed or transferred to the Resolution Trust Corporation (RTC)). FRF is administered by the Federal Deposit Insurance Corporation (FDIC). The term "FSLIC" is used hereafter to refer to FSLIC and any successor to FSLIC.

transaction but could include other assets as well. Many of these covered assets are also subject to yield maintenance guarantees, under which the FSLIC guaranteed the acquirer a minimum return or yield on the value of the assets. The assistance agreements also generally grant the FSLIC the right to purchase covered assets. In addition, many of the assistance agreements permit the FSLIC to order assisted institutions to write down the value of covered assets on their books to fair market value in exchange for a payment in the amount of the write-down.

In September 1990, the Resolution Trust Corporation (RTC), in accordance with the requirements of FIRREA, issued a report to Congress and the Oversight Board of the RTC on certain FSLIC-assisted transactions (the "1988/89 FSLIC transactions"). The report recommended further study of the covered loss and other tax issues relating to these transactions. A March 4, 1991 Treasury Department report ("Treasury report") on tax issues relating to the 1988/89 FSLIC transactions concluded that deductions should not be allowed for losses that are reimbursed with exempt FSLIC assistance. The Treasury report states that the Treasury view is expected to be challenged in the courts and recommended that Congress enact clarifying legislation disallowing these deductions.[5]

Description of Proposal

General rule

Any FSLIC assistance with respect to any loss of principal, capital, or similar amount upon the disposition of an asset would be taken into account as compensation for such loss for purposes of section 165 of the Code. Any FSLIC assistance with respect to any debt would be taken into account for purposes of determining whether such debt is worthless (or the extent to which such debt is worthless) and in determining the amount of any addition to a reserve for bad debts.[6] For this purpose, FSLIC assistance means any assistance or right to assistance with respect to a domestic building and loan association (as defined in section

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[5] Department of the Treasury, Report on Tax Issues Relating to the 1988/89 Federal Savings and Loan Insurance Corporation Assisted Transactions, March, 1991 at pp. 16-17.

[6] It is expected that, for purposes of the adjusted current earnings adjustment of the corporate alternative minimum tax, there will not be any net positive adjustment to the extent that FSLIC assistance is taken into account as compensation for a loss or in determining worthlessness and there is, therefore, no deductible loss or bad debt charge-off.

7701(a)(19) of the Code without regard to subparagraph (C) thereof) under section 406(f) of the National Housing Act or section 21A of the Federal Home Loan Bank Act (or under any similar provision of law).[7]

Financial assistance to which the FIRREA amendments apply

The proposal would not apply to any financial assistance to which the amendments made by section 1401(a)(3) of FIRREA apply.

No inference

No inference would be intended as to prior law or as to the treatment of any item to which this proposal does not apply.

The proposal was included in H.R. 4210 as passed by the House and Senate.

Effective Date

In general

The proposal would apply to financial assistance credited on or after March 4, 1991, with respect to (1) assets disposed of and charge-offs made in taxable years ending on or after March 4, 1991; and (2) assets disposed of and charge-offs made in taxable years ending before March 4, 1991, but only for purposes of determining the amount of any net operating loss carryover to a taxable year ending on or after March 4, 1991.

For this purpose, financial assistance generally would be considered to be credited when the taxpayer makes an approved debit entry to a Special Reserve Account[8] required

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7 FSLIC assistance for purposes of the proposal does not include "net worth assistance". "Net worth assistance" is generally computed at the time of an acquisition, without targeting loss coverage to ultimate dispositions or write-downs with respect to particular assets.

8 Under most assistance agreements, one or more Special Reserve Accounts are established and maintained to account for the amount of FSLIC assistance owed by the FSLIC to the acquired entity. The assistance agreements generally specify the precise circumstances under which amounts with respect to covered assets are debited to an account. Under the assistance agreements, these debit entries generally are made subject to prior FSLIC direction or approval. When amounts (Footnote continued)

to be maintained under the assistance agreement to reflect the asset disposition or write-down. An amount would also be considered to be credited prior to March 4, 1991 if the asset was sold, with prior FSLIC approval, before that date.

An amount would not be deemed to be credited for purposes of the provision merely because the FSLIC has approved a management or business plan or similar plan with respect to an asset or group of assets, or has otherwise generally approved a value with respect to an asset.

<u>Application to certain net operating losses</u>

The proposal would apply to the determination of any net operating loss[9] carried into a taxable year ending on or after March 4, 1991, to the extent that the net operating loss is attributable to a loss or charge-off for which the taxpayer had a right to FSLIC assistance which had not been credited before March 4, 1991.

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[8](continued)
are so debited, the FSLIC generally becomes obligated to pay the debited balance in the account to the acquirer at such times and subject to such offsets as are specified in the assistance agreement.

[9] For purposes of determining any alternative minimum tax net operating loss carryover to periods ending on or after March 4, 1991, it is expected that the principles described in the foootnote above, regarding the adjusted current earnings adjustment, will apply.