DESCRIPTION OF CHAIRMAN'S MARK RELATING TO FINANCING OPTIONS FOR IMPLEMENTING THE URUGUAY ROUND AGREEMENT OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)

Scheduled for Consideration
by the
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Prepared by the Staff
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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's mark for financing the implementation of the Uruguay Round Agreement of the General Agreement on Tariffs and Trade (GATT), based on recommendations made by the Administration. The Senate Committee on Finance is scheduled to consider these financing options on July 28, 1994.

Part I of the document provides a brief discussion of the major components for offsetting the costs of the Uruguay Round Agreement of the General Agreement on Tariffs and Trade. Part II contains detailed descriptions of the items in the revenue component of the mark.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Chairman's Mark Relating to Financing Options for Implementing the Uruguay Round Agreement of the General Agreement on Tariffs and Trade (GATT) (JCX-11-94), July 28, 1994.

I. OFFSETTING THE COSTS OF THE URUGUAY ROUND AGREEMENT OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE

The CBO estimates that for the period 1995-1999, the implementation of the Uruguay Round of GATT will increase the deficit by approximately $11.5 billion.

The Chairman's mark adopts the recommendations of the Administration to offset these costs through a combination of outlay reductions, revenue provisions and previously enacted legislation (pay-go balances). Proposed outlay reductions, when added to reductions proposed by the Administration for other Committees, total approximately $4.5 billion over the five-year window. Previously enacted legislation contributes an additional $2 billion in offsets over the same period. Together, these two components total about $6.5 billion. In addition, the Chairman's mark proposes compliance and timing changes with respect to revenues that yield between $4 and $4.5 billion over the period. The mark also includes three other revenue proposals, primarily extensions of current law, that yield approximately $500 million more in offsets.

Part II of this document describes the revenue proposals in greater detail.

II. DESCRIPTION OF FINANCING OPTIONS

A. Estimated Tax Treatment of Subpart F Inclusions and Inclusions of Certain Amounts Under Section 936

Present Law

Estimated tax rules--in general

Taxpayers are subject to an addition to tax for any underpayment of estimated tax. A corporation does not have an underpayment of estimated tax if it makes four equal, timely estimated tax payments that total at least 100 percent of the tax liability shown on its return for the current taxable year. A corporation that is not a "large corporation" (i.e., one that did not have taxable income of $1 million or more for any of the three preceding taxable years) 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. In addition, any corporation may base its first quarterly installment on its prior-year tax liability in order to avoid the addition to tax.

Individuals generally do not have an underpayment of estimated tax if timely estimated tax payments are made that are at least equal to (1) 100 percent of the tax shown on the individual's return for the preceding year, or (2) 90 percent of the tax shown on the return for the current year. A safe harbor of 110 percent of last year's liability applies, in lieu of the general 100 percent safe harbor, if the taxpayer had adjusted gross income of more than $150,000 for the prior taxable year.

Estimated tax installments based on annualized income

If estimated tax installments fall short under the foregoing rules, a taxpayer may nevertheless be treated as not having made an underpayment of estimated tax if the installments are based on a fraction of the "annualized" amount of actual income earned over a specified period (within the current taxable year) that ends before the due date of the installment. For corporations, these annualization periods exclude the last month of the corporation's taxable year.

Subpart F inclusions

Under the rules of subpart F (Code secs. 951-964), if a U.S. shareholder owns the stock of a controlled foreign corporation on the last day of the corporation's taxable year, then the U.S. shareholder may be required to include in its own income certain income or earnings of the controlled foreign corporation. For purposes of computing required installments of estimated tax

under the annualization method, the IRS has ruled that a taxpayer may treat certain income inclusions under subpart F as income actually earned by the U.S. shareholder on the last day of the controlled foreign corporation's taxable year.[2] The ruling involved a U.S. corporation that owned all of the stock of a number of controlled foreign corporations. All of the corporations involved used the calendar year as their taxable years. As a result, the U.S. taxpayer was not required to take its pro-rata share of subpart F income into account in determining its estimated tax installments based on the annualization method.

Inclusions pursuant to section 936(h)

Certain domestic corporations with business operations in the U.S. possessions elect the use of the section 936 credit. This credit generally eliminates some or all of the U.S. tax on certain income related to their operations in the possessions. If such a corporation (a "936 corporation") is to receive the full benefit of the section 936 credit, and the business operations in the possession relate to certain types of intangible property, then certain shareholders and affiliates of the 936 corporation generally must include in their taxable incomes certain amounts relating to income from the intangible property, either under a general rule that requires all intangible property income to be allocated to the corporation's U.S. shareholders, or under either a profit split or cost sharing approach.

For estimated tax purposes, intangible property income inclusions of a 936 corporation's shareholders or amounts allocated to shareholders or affiliates under either the profit split or cost sharing rules may be deemed to occur either at the close of the 936 corporation's taxable year, or on the last day of the taxable year of the shareholder or affiliate in which or with which the taxable year of the 936 corporation ends. Thus, in some cases, a shareholder or affiliate of a 936 corporation may utilize the annualization method to avoid penalties for underpayment of estimated tax, yet delay paying tax on intangible property income inclusions until as late as the due date of its annual tax return.

Description of Chairman's Mark

If a taxpayer pays estimated tax installments based on annualized amounts of actual income earned prior to the due date of the installment, then the taxpayer would be required under the proposal to treat amounts includible under subpart F as having been earned by the taxpayer throughout the taxable year.

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[2] PLR 9233001 (April 28, 1992).

Similarly, if a taxpayer uses the annualization method of computing estimated tax liability, then for estimated tax purposes, the proposal would require that taxpayer to take into account throughout the taxable year the intangible property income, profit split amount, or cost sharing amount includible in its taxable income under section 936. As a result, estimated tax payments generally would be required to be made throughout the year for subpart F inclusions and certain amounts includible under section 936 for the year.

In certain cases, the proposal would permit the use of a safe harbor, for purposes of the annualization method, based on amounts included in taxable income under subpart F or section 936 in the taxpayer's preceding taxable year. This safe harbor would be available to all individual taxpayers and to corporations that do not directly, indirectly, or constructively control the controlled foreign corporation or section 936 corporation.

Effective Date

The proposal would be effective for estimated tax payments relating to taxable years beginning after December 31, 1994.

B. Modify Inventory Accounting Rules

Present Law

In general

When, in the opinion of the Secretary of the Treasury, the use of inventories is necessary to clearly determine the income of a taxpayer, inventories are to be taken by the taxpayer in a manner prescribed by the Secretary, conforming as nearly as possible to the best accounting practices in the taxpayer's trade or business and as most clearly reflects income. A taxpayer that sells goods in the active conduct of its trade or business generally must maintain inventory records in order to determine the cost of goods it sold during the taxable period. Cost of goods sold generally is determined by adding the taxpayer's inventory at the beginning of the period to purchases made during the period and subtracting from that sum the taxpayer's inventory at the end of the period.

Because of the difficulty of accounting for inventory on a specific item-by-item basis, taxpayers often use conventions that assume certain item or cost flows. Among the conventions that a taxpayer may choose are the "first-in-first-out" (FIFO) method which assumes that the items in ending inventory are those most recently acquired by the taxpayer, and the "last-in-first-out" (LIFO) method which assumes that the items in ending inventory are those earliest acquired by the taxpayer. Accounting for inventory under the LIFO method tends to decrease taxable income during periods of inventory price inflation. Taxpayers are required to use a LIFO inventory method for financial accounting purposes in order to use the method for Federal income tax purposes. The FIFO and LIFO methods are general methods of accounting for inventory that may be specifically applied by different taxpayers in different ways.

Lower of cost or market under the FIFO method

Treasury regulations provide that taxpayers that maintain inventories under the FIFO method may determine the value of ending inventory under the (1) cost or (2) "lower of cost or market" (LCM) method (Treas. reg. sec. 1.471-2(c)). Under the LCM method, the value of ending inventory is written down if its market value is less than its cost. For manufacturers and processors, market value generally is the taxpayer's reproduction cost for the goods. With respect to normal goods, the LCM method is not available to taxpayers using the LIFO method for inventory (Treas. reg. sec. 1.471-2(d)). The LIFO method requires goods to be inventoried at cost (sec. 472(b)).

Any goods that are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear,

changes of style, broken lots, or other similar causes ("subnormal goods") may be valued at bona fide selling prices, less direct costs of disposition (Treas. reg. sec. 1.471-2(c)).

Components of cost method under the LIFO method

Taxpayers using the LIFO method to account for inventories may use the "dollar-value" LIFO method. Under the dollar-value LIFO method, inventory items are expressed in terms of "base-year" costs and are grouped in inventory pools. Total base-year costs by pool, rather than the quantity of specific goods, are used to measure inventory increases and decreases. If ending inventory at base-year costs is greater than beginning inventory at base-year costs (i.e., there has been an increase in inventory), such increase is valued at current-year costs. Taxpayers define items in the pool under the "total product cost" (TPC) method or the "components of cost" (COC) method. Under the TPC method, ending inventory is determined by valuing the items in ending inventory by the base-year cost of producing such items. Under the COC method, taxpayers measure ending inventory not with reference to the total product cost of producing the items in ending inventory, but rather treat the units of production (i.e., the amount of material, labor, and overhead) that were used to produce the inventory as separate items.

The application of the COC method to labor and overhead is unclear under present law.[3] Accordingly, the COC method as applied by some taxpayers may produce different results than the TPC method whenever a taxpayer's production processes change between the base year and the current year. For example, assume that in the base year the taxpayer can produce an item by applying 5 units of material at $8 a unit, 10 hours of labor at $10 an hour, and 10 hours of overhead at $5 an hour.[4] Thus, it costs $190 to produce an item in the base year (5 times $8, plus 10 times $10, plus 10 times $5). Further assume that: (1) the

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[3] The use of the COC method as applied by some taxpayers with respect to labor and overhead costs is not specifically provided for in the Code or regulations, but such method may be used for financial accounting purposes. Treasury regulations allow taxpayers to treat raw materials (and the raw material content of work-in-process and finished goods) as a separate item under the LIFO method (Treas. reg. sec. 1.472-1(c)). The Internal Revenue Service has ruled under the particular facts and circumstances of one taxpayer that the application of the COC method by that taxpayer did not clearly reflect income (Technical Advice Memorandum 9405005).

[4] In this example, overhead is allocated to inventory pursuant to a burden rate based on labor hours. Such allocations are common.

taxpayer's production processes change such that in the current year it now takes 5 units of materials, 5 hours of labor, and 5 hours of overhead to produce the same item; (2) the prices for materials, labor, and overhead have remained constant from the base year to the current year; and (3) one item of inventory remains at the end of the current year. Under the TPC method, because prices have remained constant, ending inventory would be valued at $190 (the total product cost of producing one item in the base year). Under the way COC has been applied by some taxpayers, ending inventory could be valued at $115 (5 units of materials times $8, plus 5 hours of labor times $10, plus 5 hours of overhead $5). Thus, in this example, application of the COC method in this manner would reduce taxable income by $75 ($190 less $115) in the current year as compared to the TPC method.

Indexing under the LIFO method

The use of a dollar-value LIFO method involves the comparison of base-year costs and current-year costs. In applying the method, a taxpayer may use its actual inventory costs (i.e., by using internally-generated price indexes). Alternatively, the Code and regulations allow taxpayers to use indexes constructed from tables of price changes published by the Bureau of Labor Statistics (BLS). Eligible small businesses may elect to use a simplified dollar-value method for pricing LIFO inventories (Code sec. 474). This simplified method utilizes 100 percent of the price changes in the appropriate BLS index and is available to taxpayers with average annual gross receipts for the preceding three taxable years of $5 million or less. Regulations also allow the use of BLS indexes for retailers that qualify as department stores (Treas. reg. sec. 1.472-1(k)). Finally, under regulations, other taxpayers may use certain BLS consumer or producer price indexes in their LIFO calculations, but are limited to 80 percent of the price changes indicated by the indexes (Treas. reg. sec. 1.472-8(e)).

Description of Chairman's Mark

In general

The proposal would: (1) disallow the use of the LCM method and write-downs of subnormal goods; (2) disallow the use of the COC method; and (3) provide an elective simplified dollar-value LIFO method available for all taxpayers.

LCM method and treatment of subnormal goods

The proposal would repeal the provisions in the regulations that allow taxpayers to use the LCM method and to write down the value of subnormal goods. Appropriate anti-abuse rules would apply such that taxpayers could not avoid the proposal through wash sales. The proposal would not apply to taxpayers with

average annual gross receipts for the preceding three taxable years of $5 million or less. Any change in a taxpayer's method of accounting required by the proposal would be treated as initiated by the taxpayer with the consent of the Secretary of the Treasury and any adjustment required by section 481(a) as a result of the change would be taken into account ratably over a four-year period. Similar changes would be made to section 312(n)(4) (relating to the calculation of earnings and profits) and section 1363(d)(3) (relating to the recapture of LIFO benefits upon election to be treated as a subchapter S corporation).

Repeal of the COC method

The proposal would disallow the use of the COC method. Taxpayers using the dollar-value LIFO method generally would be allowed to use a TPC method for valuing inventory. For this purpose, the simplified LIFO method provided by the proposal would be considered to be a TPC method. For taxpayers continuing to use a LIFO method of valuing inventory, the proposal would be applied on a cut-off basis. Thus, taxpayers would not be required to make a section 481(a) adjustment to reflect the change from the COC method to a TPC method.

As an alternative to a TPC method, taxpayers would be allowed to apply a LIFO method to raw materials and the raw material content of work-in-process and finished goods inventories as long as a method other than LIFO (generally, FIFO) is separately used for labor and overhead content. Taxpayers that terminate their LIFO election for labor and overhead would be required to determine a section 481(a) adjustment to reflect such change and the adjustment would be taken into account ratably over a four-year period.

Simplified dollar-value LIFO method

The proposal would provide an election to use a simplified dollar-value method for pricing LIFO inventories. The election would be available to all taxpayers eligible to use LIFO and would be similar to the indexing methods described in Code section 474 and Treasury regulation section 1.472-8(e)(3). The simplified method would allow all taxpayers to use 100 percent of the percent change in the appropriate BLS index and would provide simplified rules for purposes of determining the appropriate indexes. Adoptions of the simplified method would be made on a cut-off basis (i.e., no section 481(a) adjustment would be required). As under present law, taxpayers would be allowed to change from a FIFO method to the simplified dollar-value LIFO method. Taxpayers electing the simplified method in the first year it becomes available would be allowed to do so without obtaining the permission of the Secretary of the Treasury.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1994.

C. Partnership Distributions of Marketable Securities

Present Law

Neither a partnership nor its partners generally recognize gain upon a distribution of partnership property to a partner,[5] except that a partner recognizes gain to the extent that the amount of money distributed exceeds the partner's basis in its partnership interest immediately before the distribution.

A partner's basis in property distributed in a non-liquidating distribution is the lesser of the partnership's adjusted basis in the distributed property or the partner's adjusted basis in the partnership interest (reduced by money distributed in the transaction). A partner's adjusted basis in its partnership interest is reduced by the amount of money and the basis of property distributed to him in a non-liquidating distribution.

In a liquidating distribution, the partner's basis in the distributed property equals the partner's basis in the partnership interest (reduced by money distributed in the transaction).

In general, then, if a partnership distributes cash to a partner in an amount that exceeds the adjusted basis of its partnership interest, the partner must recognize gain; but if the partnership distributes marketable securities to the partner in lieu of cash, the partner can defer recognizing gain.

Description of Chairman's Mark

Under the proposal, a partner would recognize gain on the distribution by a partnership of marketable securities to the extent the fair market value of the marketable securities exceeds the partner's adjusted basis in its partnership interest immediately before the distribution. The partner's basis in the distributed securities would be increased by the amount of gain recognized under the proposal.

The proposal would provide exceptions. The proposal would not apply to a partnership distribution (1) of marketable securities that the distributee partner contributed, (2) that does not exceed the distributee partner's proportionate share of

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[5] Exceptions to this general nonrecognition rule for asset distributions include certain distributions of property contributed by a partner or of other property when the partnership holds contributed property; disguised sale transactions; and certain disproportionate distributions that are treated as sales or exchanges.

the securities (taking into account all the facts and circumstances, including the terms of the partnership agreement), or (3) by an investment partnership to a partner who contributed no property other than cash or securities. An investment partnership would mean any partnership (1) that has never been engaged in the active conduct of a trade or business, and (2) in which substantially all of the assets have always consisted of money and securities and other financial instruments such as debt instruments, notional principal contracts and derivative financial instruments. In determining whether a partnership has been engaged in a trade or business, activities undertaken as an investor, trader, or dealer in securities are not taken into account.

A marketable security would mean any security for which there is a market on an established securities market or otherwise. Rules would be provided to treat as a marketable security a distributed interest in an entity if, e.g., at the time of the distribution substantially all the assets of the entity directly or indirectly consist of marketable securities and money.

Regulatory authority would be provided, including authority to prevent avoidance of the rules, to address tiered partnership arrangements, and to apply the rules to distributions of other readily tradeable property (e.g., commodities and foreign currency).

Effective Date

The proposal generally would apply to partnership distributions after the date of enactment, except that the proposal would not apply to partnership distributions before January 1, 1995, of marketable securities held by the partnership on or before July 27, 1994. A transition rule would provide that the proposal does not apply to a partnership distribution of marketable securities in liquidation of a partner's interest pursuant to a written contract that is binding on July 15, 1994 and at all times thereafter (and subject to no material contingencies) to purchase the partner's interest in the partnership by a date certain for a fixed dollar amount of marketable securities specified in the contract or for other property; provided that this transition rule does not apply if the partner has the right to choose to receive payment in money or other property in lieu of marketable securities.

D. Withholding on Distributions of Indian Casino Profits to Tribal Members

Present Law

In ordinary matters not governed by treaties or remedial legislation, Indians are subject to the payment of Federal income tax as are other citizens. Income received by Indian tribal governments, and by tribal corporations established under Federal law, from activities conducted on or off reservations generally is exempt from Federal income tax (Rev. Rul. 94-16, IRB No. 1994-12).

Gaming activities conducted by Indian tribes are classified in 25 U.S.C. 2703. Class I gaming activities are social games solely for prizes of minimal value or traditional forms of Indian gaming engaged in as part of tribal ceremonies. Class II gaming activities generally are bingo, games similar to bingo (e.g., pull tabs, punchboards, tip jars, and instant bingo) and card games either (1) explicitly authorized by the State or (2) not explicitly prohibited by the State, played at any location in the State, and conducted in conformity with any State regulations regarding periods of operation or wagering limitations. Class II gaming activities do not include any banking card games (e.g., baccarat, chemin de fer, or blackjack), slot machines or any electronic or electromagnetical facsimiles of games of chance. Class III gaming activities are all forms of gaming that are not classified as Class I or Class II.

Net revenues from certain gaming activities conducted or licensed by an Indian tribe may be used to make taxable distributions to members of the Indian tribe. The tribe must notify its members of the tax liability at the time the payments are made. 25 U.S.C. 2710(b)(3) and (d)(1). The tribe is not required to withhold on such payments except to the extent backup withholding rules apply under Code section 3406.

Description of Chairman's Mark

An Indian tribe that uses net revenues from gaming activities (except for class I gaming activities as defined in 25 U.S.C. 2703(6) as in effect on July 28, 1994) to make taxable distributions to its members would be required to withhold on such payments in accordance with the following schedule:

(1) The withholding rate would be zero to the extent the payment, when annualized, does not exceed the sum of one personal exemption and the standard deduction for a single person for the calendar year in which the payment is made.

(2) The withholding rate would be 15 percent to the extent the payment, when annualized, exceeds the highest amount to

which the zero percent withholding rate applies under (1) but does not exceed the sum of that amount and the amount of taxable income to which, in the case of a single person, the 15 percent tax rate would apply for the calendar year in which the payment is made.

(3) The withholding rate would be 28 percent to the extent the payment, when annualized, exceeds the highest amount to which the 15 percent withholding rate applies under (2) but does not exceed the sum of that amount and the amount of taxable income to which, in the case of a single person, the 28 percent tax rate would apply for the calendar year in which the payment is made.

(4) The withholding rate would be 31 percent to the extent the payment, when annualized, exceeds the highest amount to which the 28 percent withholding rate applies under (3).

Alternatively, the tribe would be allowed to withhold on such payments in accordance with such tables or computational procedures as the Secretary may prescribe.

Effective Date

The proposal would be effective for payments made after December 31, 1994.

E. Acceleration of Deposits of Payments for Certain Excise Taxes

Present Law

The Code imposes excise taxes on certain communications services (sec. 4251 et seq.), air transportation, (sec. 4261 et seq., tobacco products and cigarette papers and tubes (sec. 5701 et seq.), and alcoholic beverages (distilled spirits, wine, and beer) (sec. 5001 et seq.). The excise taxes on communications services and air transportation are paid by the person receiving the services (the customer), but are collected by the service provider. The excise taxes on tobacco products and alcoholic beverages are paid by manufacturers or importers of such products.

All of these taxes are generally required to be deposited or paid on a semi-monthly basis. With respect to communications services and air transportation excise taxes, service providers may make semi-monthly deposits on the basis of amounts actually collected during the period; such deposits must be made by the 9th day of the following period. Alternatively, deposits may be made on the basis of amounts considered collected during the first week of the period, in which case the deposit must be made by the third banking day after the end of that week. Section 7503 of the Code provides that, if the day for deposit of a tax would otherwise fall on a Saturday, Sunday, or legal holiday, the due date is the next succeeding day which is not a Saturday, Sunday, or legal holiday.

Payments of the tobacco products and alcoholic beverage excise taxes for a semi-monthly period generally must be made by the 14th day after the last day of the period. If the date for payment of these taxes would otherwise fall on a Saturday, Sunday, or legal holiday, the due date is the immediately preceding day which is not a Saturday, Sunday, or legal holiday. Small wine producers (generally, producers who paid less than $1,000 of wine excise tax during the preceding calendar year) may pay the wine excise tax on an annual basis by remitting the tax for the calendar year within 30 days after its end.

Description of Chairman's Mark

The proposal would accelerate the due date for deposit (or payment) of communications services, air transportation, tobacco products and alcoholic beverage excise taxes for the period September 16 through September 22 to September 27th (rather than in the subsequent fiscal year).[6] This provision would not apply

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[6] This proposal generally would conform the communications services, air transportation, tobacco products,

to wine excise taxes that are remitted on an annual basis.

As under the present-law rules applicable to tobacco products and alcoholic beverages, if September 27 is a Saturday, Sunday, or legal holiday, deposits and payments of taxes otherwise due on that date would be due on or before the immediately preceding day which is not a Saturday, Sunday, or legal holiday.

Effective Date

The proposal would be effective on January 1, 1995, for the communications services, tobacco products and alcoholic beverages excise taxes and on January 1, 1997, for the air transportation excise taxes.

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and alcohol
excise tax deposit (or payment) requirements to those applicable under present law to gasoline and diesel fuel excise taxes.

F. Require Taxpayer Identification Numbers for All Children Regardless of Age

Present Law

A taxpayer claiming an exemption for a dependent is required to provide a taxpayer identification number (TIN) on the tax return for any dependent who has attained the age of 1 as of the close of that taxable year (sec. 6109(e)). A parallel requirement applies to taxpayers with qualifying children claiming the earned income tax credit (EITC) (sec. 32(c)(3)(D)). An individual's TIN is, in general, that individual's social security number.

Description of Chairman's Mark

The proposal would require that taxpayers claiming dependents provide a TIN for each dependent, regardless of the dependent's age. A parallel requirement would apply to taxpayers with qualifying children claiming the EITC.

Effective Date

For returns filed with respect to tax year 1995, taxpayers would be required to provide TINs for all dependents and qualifying children for EITC purposes who were born on or before October 31, 1995. For returns filed with respect to tax year 1996, taxpayers would be required to provide TINs for all dependents and qualifying children born on or before November 30, 1996. For returns filed with respect to tax year 1997, and all subsequent years, taxpayers would be required to provide TINs for all dependents and qualifying children, regardless of their age.

G. Voluntary Withholding on Taxable Federal Government Payments

Present Law

Taxpayers may choose to have income taxes withheld from pension distributions, annuity payments, or other types of payments (secs. 3405 and 3402(p)). Taxpayers may not, however, have income taxes voluntarily withheld from Social Security payments or other taxable Federal payments (e.g., Trade Adjustment Assistance, crop disaster payments, Commodity Credit Corporation loans, agricultural price supports).

Description of Chairman's Mark

Taxpayers who receive specified Federal payments would be given the option of requesting that the Federal agency making the payments withhold Federal income taxes from the payments. Specified Federal payments subject to the withholding option would include (1) Social Security benefits; (2) Trade Adjustment Assistance; (3) crop disaster payments; (4) Commodity Credit Corporation loans; (5) agricultural price supports; and (6) other Federal payments specified by the Secretary of the Treasury.

Where a taxpayer requests that the Federal agency making the payments withhold Federal income taxes, the taxpayer would also select the percentage of the payment that is to be withheld. The taxpayer may select withholding at 7 percent, 15 percent, 28 percent, or 31 percent. Treasury regulations may also specify additional percentage rates for withholding.

Federal agencies making the payments would not receive any additional information regarding the taxpayer's income as a consequence of this proposal.

Effective Date

The proposal would be effective for payments made after December 31, 1996.

H. Repeal of Same Condition Substitution Drawback

Present Law

Section 313 of the Tariff Act of 1930, as amended, establishes the duty drawback program, where 99 percent of the duty amount paid on imported goods can be rebated when certain exports are made. Drawbacks are intended to provide an incentive for exports. Under current law, there are several types of drawback. Drawbacks can be transferred among companies under certain circumstances.

The key types of drawback include a manufacturing drawback under sections 313(a), (b), and (p) that applies to imported material (i.e., components) used in the manufacture or production in the U.S. of finished articles which are then exported. Another drawback is the same condition drawback under section 313(j)(1) that applies to imported goods which are then re-exported without alteration (i.e., pass-through or in transit items). A third type of drawback is the substitution same condition drawback under section 313(j)(2) that allows a rebate of duties paid on imported goods which are matched with similar, imported or domestic goods ("commercially interchangeable" merchandise) that are exported within 3 years of the importation of the imported goods.

The substitution same condition drawback, which was added in 1984, was intended to, *inter alia*, ease the burdens of inventory management and recordkeeping for claims under same condition drawback. In 1993, however, the Customs Service issued regulations introducing more flexible methods of qualifying for the same condition drawback.

The North American Free Trade Agreement disallows the substitution same condition drawback for goods traded among the U.S., Canada, and Mexico.

Description of Chairman's Mark

The substitution same condition drawback under section 313(j)(2) would be repealed. Other forms of drawback would not be affected.

Effective Date

The proposal would be effective for goods exported after December 31, 1994.

I. Decrease Rate of Interest Paid on Overpayments of Tax

Present Law

The rate of interest that IRS pays to taxpayers on overpayments of tax is the sum of the Federal short-term rate plus 2 percentage points (sec. 6621(a)(1)).

Description of Chairman's Mark

In general, the overpayment rate would be reduced to the sum of the Federal short-term rate plus one-half percentage point. A special rule would apply to income taxes only. Under this special rule, the overpayment rate would be the same as under present law for the first $2,000 of the overpayment, and would be the proposed lower rate for any portion of an overpayment that exceeds $2,000.

Effective Date

The proposal would be effective for purposes of determining interest for periods after December 31, 1994, regardless of the taxable period (if any) to which the underlying tax may relate.

J. Rounding Rules for Cost-Of-Living Adjustments

Present Law

Under present law, the dollar limit on benefits under a defined benefit pension plan ($118,800 for 1994), the limit on elective deferrals under a qualified cash or deferred arrangement ($9,240 for 1994), and the minimum compensation limit for determining eligibility for participation in a simplified employee pension (SEP) ($396 for 1994) are adjusted annually for inflation. The dollar limit on annual additions to a defined contribution plan is the greater of $30,000 or 1/4 of the dollar limit for benefits under defined benefit pension plans. Thus, the dollar limit will be $30,000 until the defined benefit pension plan dollar limit exceeds $120,000. The dollar limit on compensation that generally may be taken into account for qualified plan purposes is $150,000. The $150,000 limit is indexed in $10,000 increments.

Description of Chairman's Mark

The proposal would provide that (1) the dollar limit on benefits under a defined benefit pension plan is indexed in $5,000 increments, (2) the dollar limit on annual additions under a defined contribution plan is indexed in $5,000 increments, (3) the limit on elective deferrals is indexed in $500 increments, (4) as under present law, the compensation limit is indexed in $10,000 increments, and (5) the minimum compensation limit for SEP participation is indexed in $50 increments. In each case, the limits would be rounded to the next lowest multiple of the increment. In addition, the proposal would provide that the cost-of-living adjustment with respect to any calendar year is based on the increase in the applicable index as of the close of the calendar quarter ending September 30 of the preceding calendar year so that the adjusted dollar limits would be available before the beginning of the calendar year to which they apply.

Effective Date

The proposal would be effective for years beginning after December 31, 1994.

K. Extend IRS User Fees

Present Law

The Internal Revenue Service (IRS) provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS responds to these inquiries through the issuance of letter rulings, determination letters, and opinion letters. The IRS generally charges a fee for requests for a letter ruling, determination letter opinion letter, or other similar ruling or determination. The legislation that requires the establishment of this fee program provides that it is not to apply to requests made after September 30, 1995.

Description of Chairman's Mark

The IRS user fee program would be extended for five years.

Effective Date

The proposal would apply to requests made after September 30, 1995, and before October 1, 2000.

L. Increase in Inclusion of Social Security and Railroad Retirement Tier 1 Benefits Paid to Nonresident Alien Individuals

Present Law

Treatment of taxpayers generally

A portion of Social Security and Railroad Retirement Tier 1 benefits is includible in gross income for taxpayers whose provisional incomes exceed a threshold amount (the "base amount"). For taxpayers whose provisional incomes exceed a second threshold amount (the "adjusted base amount"), a larger portion of such benefits is includible in gross income. For purposes of these computations, a taxpayer's provisional income includes modified adjusted gross income (adjusted gross income plus tax-exempt interest plus certain foreign source income) plus one-half of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit. The base amount is $32,000 for married taxpayers filing joint returns, $25,000 for unmarried taxpayers, and $0 for married taxpayers filing separate returns. The adjusted base amount is $44,000 for married taxpayers filing joint returns, $34,000 for unmarried taxpayers, and $0 for married taxpayers filing separate returns.

If the amount of provisional income exceeds the base amount but does not exceed the adjusted base amount, then the amount of the inclusion is the lesser of (1) 50 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit, or (2) 50 percent of the excess of the taxpayer's provisional income over the base amount.

If the amount of provisional income exceeds the adjusted base amount, then the amount of the inclusion is the lesser of:

(1) 85 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit or

(2) the sum of:

(a) 85 percent of the excess of the taxpayer's provisional income over the adjusted base amount, plus

(b) the smaller of (i) the amount of benefits that would have been included if the 50-percent inclusion rule (the rule in the previous paragraph) were applied, or (ii) one-half of the difference between the adjusted base amount and the base amount of the taxpayer.

Beginning in 1983 (when benefits were included in income pursuant to the Social Security Amendments of 1983 (the "1983

Act")) and continuing until the Omnibus Budget Reconciliation Act of 1993 (the "1993 Act"), in all cases where provisional income was over the base amount, the amounts included were limited by the lesser of 50 percent of the taxpayer's benefits, or 50 percent of the excess of provisional income over the base amount.

Treatment of nonresident alien individuals

If a nonresident alien individual is engaged in a trade or business within the United States during the taxable year, the individual is subject to tax under the Code, at the normal graduated rates, on net taxable income that is effectively connected with the conduct of the trade or business. U.S. source fixed or determinable annual or periodical income of a nonresident alien individual (for example, salary, wages, annuities, compensation, remuneration, and emoluments) that is not effectively connected with the conduct of a U.S. trade or business generally is subject to tax under the Code at a rate of 30 percent of the gross amount paid. This latter tax generally is collected by means of withholding (hence this tax is often called a "withholding tax"). Withholding taxes are often reduced or eliminated in the case of payments to residents of countries with which the United States has an income tax treaty.

Under rules that have been in the Code since the 1983 Act, for purposes of taxing the income of nonresident alien individuals, the income thresholds for including Social Security and Railroad Retirement Tier 1 benefits do not apply. Instead, 50 percent of any such benefit is included in gross income. Thus, a nonresident alien individual typically may be subject to U.S. withholding tax under the Code at an effective rate of 15 percent on the gross amount of U.S. social security benefits. This tax may be reduced or eliminated under some treaties. Although the 1993 Act increased the inclusion of benefits in some cases, for taxpayers other than nonresident aliens, to up to 85 percent of the benefits, the 1993 Act did not amend the rule that a nonresident alien individual is required to include 50 percent (and only 50 percent) of these benefits in gross income.

Description of Chairman's Mark

The proposal would increase from 50 percent to 85 percent the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual. Thus, under the proposal a nonresident alien individual may be subject to U.S. withholding tax under the Code at an effective rate of 25.5 percent on the gross amount of U.S. Social Security or Railroad Retirement Tier 1 benefits.

The proposal would not impose tax contrary to any treaty obligation of the United States. Thus, in cases where taxation

of such a benefit would conflict with an existing treaty, the treaty would continue to prevail.

Effective Date

The proposal would be effective for benefits paid after December 31, 1994.

M. Denial of the Earned Income Tax Credit to Certain Nonresident Aliens

Present Law

In general

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit depends upon whether the taxpayer has one, more than one, or no qualifying children. Taxpayers with one qualifying child may claim a credit of up to 26.3 percent of the first $7,750 of earned income for 1994. The maximum amount of credit for 1994 for these taxpayers is $2,038. This maximum credit is reduced by 15.98 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. The EITC is totally phased out for these workers with earned income (or adjusted gross income, if greater) over $23,753.

Taxpayers with more than one qualifying child may claim a credit of up to 30 percent of the first $8,425 of earned income for 1994. The maximum amount of credit for 1994 for these taxpayers is $2,528. This maximum credit is reduced by 17.68 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. The EITC is totally phased out for these workers with earned income (or adjusted gross income, if greater) over $25,299.

Taxpayers with no qualifying child may claim a credit of up to 7.65 percent of the first $4,000 of earned income for 1994. The maximum amount of credit for 1994 for these taxpayers is $306. This maximum credit is reduced by 7.65 percent of earned income (or adjusted gross income, if greater) in excess of $5,000. The EITC is totally phased out for these workers with earned income (or adjusted gross income, if greater) over $9,000.

The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

	One qualifying child--		Two or more qualifying children--		No qualifying children--	
Year	Credit rate	Phaseout rate	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1994	26.30	15.98	30.00	17.68	7.65	7.65
1995	34.00	15.98	36.00	20.22	7.65	7.65
1996 and after	34.00	15.98	40.00	21.06	7.65	7.65

In order to claim the EITC, a taxpayer must either have a qualifying child or must meet other requirements. A qualifying child must meet a relationship test, an age test, and a residence test. Part of the residence test requires that a qualifying child must have the same principal place of abode as the taxpayer for more than one-half of the taxable year (for the entire taxable year in the case of a foster child), and that this principal place of abode must be located in the United States.

In order to claim the EITC without a qualifying child, a taxpayer must not be a dependent and must be over age 25 and below age 65. In addition, the taxpayer's principal place of abode must be located in the United States for more than one-half of the taxable year.

Nonresidents and the EITC

The EITC may be claimed by a taxpayer meeting the above requirements regardless of whether the taxpayer is a U.S. citizen, a resident alien, or a nonresident alien.

Section 7701(b) defines a resident alien for income tax purposes. Aliens who do not meet this definition are nonresident aliens. For income tax purposes, an individual is generally considered a resident if the individual:

(1) has entered the United States as a lawful permanent U.S. resident (the "green card test"); or

(2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for 183 or more days during a 3-year period weighted toward the present year (the "substantial presence

test"). (An individual who is present in the United States for fewer than 183 days and establishes that he or she has a closer connection with a foreign country than with the United States is generally not subject to tax as a resident alien on account of the substantial presence test.)

A nonresident alien may elect to be taxed as a resident alien if one of several elections is made:

(1) Under section 6013(g), a nonresident alien who is married to an individual who is either a citizen or resident alien of the United States at year end may elect to be treated as a resident for the entire year. The election applies to the year for which it is made and all subsequent years until terminated. However, the election will be suspended if neither spouse is a U.S. citizen or resident at any time during a taxable year.

(2) An election under section 6013(h) to be taxed as a resident alien for the entire taxable year may be made by an individual who is a nonresident alien at the beginning of the year and a resident alien at the end of the year and who is married to an individual who is either a citizen or resident of the United States at year end. Thus, this election can be made by a foreign married couple who arrive in the United States during the taxable year and who are resident aliens at year end.

Description of Chairman's Mark

The proposal would make nonresident aliens ineligible to claim the EITC unless an election under Code section 6013(g) or (h) is in effect for the taxable year with respect to the nonresident alien.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1994.

N. Extension of the Earned Income Tax Credit to Military Personnel Stationed Overseas

Present Law

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit depends upon whether the taxpayer has one, more than one, or no qualifying children. Taxpayers with one qualifying child may claim a credit of up to 26.3 percent of the first $7,750 of earned income for 1994. The maximum amount of credit for 1994 for these taxpayers is $2,038. This maximum credit is reduced by 15.98 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. The EITC is totally phased out for these workers with earned income (or adjusted gross income, if greater) over $23,753.

Taxpayers with more than one qualifying child may claim a credit of up to 30 percent of the first $8,425 of earned income for 1994. The maximum amount of credit for 1994 for these taxpayers is $2,528. This maximum credit is reduced by 17.68 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. The EITC is totally phased out for these workers with earned income (or adjusted gross income, if greater) over $25,299.

Taxpayers with no qualifying child may claim a credit of up to 7.65 percent of the first $4,000 of earned income for 1994. The maximum amount of credit for 1994 for these taxpayers is $306. This maximum credit is reduced by 7.65 percent of earned income (or adjusted gross income, if greater) in excess of $5,000. The EITC is totally phased out for these workers with earned income (or adjusted gross income, if greater) over $9,000.

The maximum amount of earned income on which the EITC may be claimed and the income threshold for the phaseout of the EITC are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates for the EITC change over time under present law, as shown in the following table.

	One qualifying child--		Two or more qualifying children--		No qualifying children--	
Year	Credit rate	Phaseout rate	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1994	26.30	15.98	30.00	17.68	7.65	7.65
1995	34.00	15.98	36.00	20.22	7.65	7.65
1996 and after	34.00	15.98	40.00	21.06	7.65	7.65

In order to claim the EITC, a taxpayer must either have a qualifying child or must meet other requirements. A qualifying child must meet a relationship test, an age test, and a residence test. Part of the residence test requires that a qualifying child must have the same principal place of abode as the taxpayer for more than one-half of the taxable year (for the entire taxable year in the case of a foster child), and that this principal place of abode must be located in the United States.

In order to claim the EITC without a qualifying child, a taxpayer must not be a dependent and must be over age 25 and below age 65. In addition, the taxpayer's principal place of abode must be located in the United States for more than one-half of the taxable year.

Description of Chairman's Mark

For any period during which a member of the Armed Forces is stationed outside the United States while serving on extended active duty, the member would not be subject to the present-law requirements to claim the EITC that the principal place of abode for a qualifying child or the member be in the United States. Thus the proposal would extend the EITC to United States military personnel stationed overseas.

The proposal also would require that members of the Armed Forces receive annual reports from the Department of Defense of earned income (which includes nontaxable earned income such as amounts received as basic allowances for housing and subsistence). This increased information reporting is intended to allow members of the Armed Forces claiming the EITC to determine more accurately the actual amount of EITC to which they are entitled.

Effective Date

Extension of the EITC to members of the Armed Forces stationed overseas would be effective for taxable years beginning after December 31, 1994. The increased information reporting would be effective for remuneration paid after December 31, 1994.

O. Use of Excess Pension Assets for Retiree Health Benefits

Present Law

Under present law, defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. Certain procedural requirements also must be met. Any assets that revert to the employer upon such termination are includible in the gross income of the employer and subject to an excise tax. The rate of the excise tax varies depending upon whether or not the employer maintains a replacement plan or makes certain benefit increases, and can be as high as 50 percent of the amount of the reversion. Upon plan termination, the accrued benefits of all plan participants are required to be 100-percent vested.

Under present law, a pension plan may provide medical benefits to retirees through a section 401(h) account that is part of such plan. Present law permits certain qualified transfers of excess assets from the pension assets in a defined benefit pension plan (other than a multiemployer plan) to the section 401(h) account that is a part of such plan. The assets transferred are not includible in the gross income of the employer and are not subject to the excise tax on reversions.

Assets transferred in a qualified transfer cannot exceed certain limits. The transferred assets (and any income thereon) are required to be used to pay qualified current retiree health liabilities (either directly or through reimbursement) for the taxable year of the transfer. Transferred amounts are generally required to benefit all participants in the pension plan who are entitled upon retirement to receive retiree medical benefits (other than key employees) through the section 401(h) account. Retiree health benefits of key employees may not be paid (directly or indirectly) out of transferred assets. In order for the transfer to be qualified, accrued retirement benefits under the pension plan must be nonforfeitable as if the plan terminated on the date of transfer.

Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned at the end of the taxable year to the general assets of the plan.

An employer that makes a transfer to a section 401(h) account from the defined benefit plan assets is required to maintain employer-provided retiree health expenditures for covered retirees at a minimum dollar level for the taxable year of the transfer and the following 4 taxable years.

The provision permitting the transfer of excess pension assets to pay current retiree health benefits expires for taxable

years beginning after December 31, 1995.

Description of Chairman's Mark

The present-law provision permitting excess defined benefit pension plan assets to be used to provide retiree health benefits under a section 401(h) account would be extended for 5 years.

Effective Date

The proposal would be effective with respect to taxable years beginning after December 31, 1995, and before January 1, 2001.