[JOINT COMMITTEE PRINT]

DESCRIPTION OF S. 1310 URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981

SCHEDULED FOR HEARINGS

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE

ON JULY 13 AND 16, 1981

PREPARED FOR THE USE OF THE

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BY THE STAFF OF THE

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INTRODUCTION

The Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee has scheduled public hearings on July 13 and 16, 1981, on S. 1310, the Urban Jobs and Enterprise Zone Act of 1981 (introduced by Senators Boschwitz, Chafee, Armstrong, Grassley and others).

This pamphlet, prepared in connection with the hearings, contains descriptions of the various provisions of the bill. Accompanying each description is a summary of the related provisions of present law.

I. SUMMARY

A. Present Law

Targeted area

The Internal Revenue Code generally does not contain rules for targeting areas. However, the provision relating to mortgage subsidy bonds defines targeted areas for the purpose of promoting housing development within these areas. Within such areas, defined on the basis of the income of area residents or the general economic condition of the area, rules for the issuance of mortgage subsidy bonds are less restrictive than the generally applicable rules.

Tax credits for employers

Present law contains no provisions under which an employer's tax liability varies according to the location of the employees. However, there are two provisions, the targeted jobs tax credit and the WIN tax credit, which provide credits against tax for a portion of wage payments made to certain groups of employees. These groups generally are defined according to the individual's physical condition, participation in a specified education program, or economic status.

Tax credit for employees and self-employed

Under present law the tax liability of an employee working in the United States generally does not vary according to the location of the employment. However, the earned income credit provides a refundable tax credit for a portion of earned income (wages, salaries, and earnings from self-employment) to families with children and with income less than $10,000.

Capital gains taxation

Noncorporate taxpayers deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital loss) for the taxable year. Corporate taxpayers compute their tax liability using a 28 percent alternative rate applied to net capital gain, if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Reduction in taxation of income derived from certain areas

Under present law, the Federal income tax liability of individuals and businesses located in the United States generally does not vary according to the location of the business within the United States. However, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income.

Cash accounting

Taxpayers generally must use the accrual method of accounting for inventories, and thus may deduct for a taxable year only the cost of goods sold in that year.

Net operating loss carryovers

Under present law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 7 years and thus may be deducted from income attributable to other taxable years within this period.

Investment credit

Under present law, a 10-percent regular investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. In addition, the credit applies to expenditures to rehabilitate industrial and commercial buildings which are at least 20 years old. Low-income housing is allowed special treatment for recapture of depreciation and for rapid amortization of rehabilitation expenditures.

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to lighten the regulatory burden of small businesses, small nonprofit organizations, or small governmental jurisdictions.

B. Summary of the Bill

Business and employers located in an enterprise zone would be entitled to various tax incentives and regulatory status, as summarized below.

Title I. Designation of enterprise zones

Enterprise zones would be designated after approval of a local government and the Secretary of Housing and Urban Development. The zone would have to satisfy various requirements concerning physical and economic characteristics. The local government seeking designation would be required to commit itself to specific actions to enhance the development of the area. The Secretary would be required to designate 10 to 25 areas as enterprise zones in each of the 3 years after enactment of the bill.

A designation would remain in effect through 2001. Whenever possible, foreign trade zones would be established within enterprise zones.

Title II. Tax incentive provisions

Tax credit for zone employers

Employers would be allowed a refundable tax credit of 5 percent of wages paid to qualified employees. Qualified employees would be individuals who perform at least 50 percent of their services within an enterprise zone and who are eligible for various programs under the Comprehensive Employment and Training Act (CETA).

Tax credit for zone employees

Qualified employees would be allowed a refundable tax credit equal to 5 percent of wages, salaries, and self-employment earnings. Qualified employees would be those who performed at least 50 percent of their services for a qualified business. A qualified business would be a person at least 50 percent of whose gross receipts were attributable to the active conduct of a trade or business within an enterprise zone and at least 40 percent of whose employees were qualified employees for purposes of the credit described above.

Elimination of capital gains taxation

Taxpayers would be allowed to deduct from gross income all net capital gains on property used in an enterprise zone in the active conduct of a trade or business or gains on an interest in a qualified business, including low-income rental property. Conforming changes would be made in the minimum tax provisions.

Reduction in taxation of zone income

A percentage of gross receipts attributable to a qualified business or of interest received from financing for a qualified business would be excluded from the taxable income attributable to that business. The percentage would be 50 percent through 1997 and would phase down to zero by 2002.

Cash accounting for zone businesses

Any qualified business with gross receipts for any prior year of $2 million or less could elect the cash method of accounting for inventories.

Extension of net operating loss carryover

Any qualified business could extend to 20 years the period that net operating losses could be carried forward.

Investment credit for low-income housing

Low-income housing located in the enterprise zone would be made eligible for the investment credit.

Simplified IRS administration

The Internal Revenue Service would be required to simplify the administration of the tax provisions added by this bill.

Title III. Regulatory flexibility

Qualified businesses, any government designating an area as an enterprise zone, and any not-for-profit enterprise operating within a zone would be accorded the same treatment under the Regulatory Flexibility Act as is now given to certain small entities.

II. DESCRIPTION OF S. 1310

(THE URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981)

A. Designation of Enterprise Zones (Title I of the Bill)

Present Law

The Internal Revenue Code contains a provision which defines targeted areas for the purpose of promoting economic development within these areas. In section 103A, relating to mortgage subsidy bonds, some rules for issuance of mortgage subsidy bonds for targeted areas are not as restrictive as the generally applicable rules. These rules were enacted in the Mortgage Subsidy Bond Tax Act of 1980 (P.L. 96–499).

For purposes of mortgage subsidy bonds, a targeted area is either a qualified census tract or an area of chronic distress. A qualified census tract is a tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median income. Areas of chronic economic distress are to be designated by a State according to its standards, and the designation must be approved by the Secretaries of Treasury and Housing and Urban Development. In evaluating a State designation, the Secretaries must use as criteria (1) the condition of the housing stock, (2) the need for housing assistance as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates, (3) the potential for designation to improve housing conditions in the area, and (4) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

Under present law, each port of entry is entitled to at least one foreign trade zone. In a foreign trade zone, a company may receive dutiable goods free of duty. These goods may be stored, sold, assembled, distributed, or manufactured, and exported, or sent into customs territory of the United States. When goods are sent from a foreign trade zone into the customs territory of the United States, they are subject to the laws affecting imported merchandise.

The bill would amend the Internal Revenue Code to provide criteria for the designation of enterprise zones.

Explanation of Provision

1. Definition of enterprise zones

An enterprise zone would be any area in the United States or its possessions which is designated as an enterprise zone by one or more local governments (or by a State government on behalf of a local government) if the Secretary of Housing and Urban Development approves the designation. The Secretary could approve the designation only after consultation with the Secretaries of Commerce, Labor, and Treasury and the Administrator of the Small Business Administration, after assurance that the local governments which seek the enterprise zone designation have authority to make local commitments (see item 4 below) and after the Secretary is satisfied that various other requirements are satisfied.

The bill specifies limits on the Secretary's authority to make a designation. No designation may be approved if (1) the application is not submitted in accordance with regulations relating to the manner, form and information of the submission; (2) any part of the area is included in an already approved zone; or (3) the chief executive officer of the State or possession files an objection with the Secretary to designation of any area within 21 days of the application.

2. Period of designation

Under the bill, any designation of an area as an enterprise zone would remain in effect through December 31, 2001. The Secretary could revoke a designation, if he determines that the local government is not substantially complying with the requirement for local commitments.

3. Area requirements

The Secretary could designate an area as an enterprise zone, if it meets requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. The designation would be made on the basis of information submitted by the local government which the Secretary determines is reasonably accurate. A description of these requirements follows:

a. The area would be required to be within the jurisdiction of the government seeking the designation, to have a continuous boundary and to include, if feasible, vacant or underutilized land or buildings conveniently accessible to residents of the area.

b. The most recent census would have to show that area population is at least 4,000 if the area is included within a standard metropolitan statistical area with 50,000 or more people or at least 2,500 in areas of smaller population, or the area would have to be an Indian reservation (as determined by the Secretary of the Interior).

c. The Secretary would have to determine that the area is one of pervasive poverty, unemployment, and general distress, and is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974.[1]

d. At least one of four additional requirements would have to be satisfied: (1) For the most recent 18-month period, the average rate of unemployment would have to be at least 1½ times the average national unemployment rate; or (2) according to its most recent census, the Bureau of the Census would have to determine that the area was a low-income poverty area; or (3) at least 70 percent of the residents living in the area would have to have income below 80 percent of

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[1] Section 119 establishes a program of urban development action grants (UDAG) to severely distressed cities and urban counties to alleviate physical and economic deterioration through reclamation of neighborhoods.

the median income of the residents of the government designating the area (determined in the same manner as under section 119(b) of the Housing and Community Development Act of 1974); or (4) the population of all census tracts in the area would have to decrease by 10 percent or more between 1970 and 1980 and the government seeking designation would have to establish with respect to the area that chronic abandonment or demolition of commercial or residential structures exists, or substantial tax arrearages of commercial or residential structures exist.

4. Required local commitment

Under the bill, a local government seeking designation of one of its areas as an enterprise zone would have to agree in writing that it would follow a course of action designed to reduce the various burdens borne by employers or employees in the area to be designated.

A course of action under the commitment could be implemented by the local government, private entities or both, could be funded from the proceeds of any Federal program, and could include (but would not be limited to) (1) reduction of tax rates or fees, (2) increase in the level or efficiency of local services, (3) simplification of governmental requirements on employers or employees, or (4) commitment from private entities in the area to provide technical, financial, or other assistance to, and jobs or job training for, employees and residents of the area.

5. Number and period of zone designations

Under the bill, the Secretary could designate areas as enterprise zones only during the period from the date of enactment through December 31, 1996. During each of the three years following the calendar year in which the bill was enacted the Secretary would be required to designate 10 to 25 areas as enterprise zones.

6. Priority of designation

In determining which areas to designate as enterprise zones, the bill provides that the Secretary would give preference to areas (1) with the highest levels of poverty, unemployment, and economic distress, (2) for which the applying local government has made (or will make) the greatest effort possible with its resources to examine and remove impediments to job creation, (3) with the widest support in meeting local commitments from the applying government, the community, residents, local business, and private organizations, and (4) where the State or possession government has made commitments similar to the commitments that would be required of local governments.

7. Coordination with other Federal programs

The coordination of Federal programs within enterprise zones would be the responsibility of the Secretary of Housing and Urban Development. Under the bill, he would promote the coordination of all Federal housing, community and economic development, banking, financial assistance and employment training programs carried on in the enterprise zone. He would expedite consideration of applications for Federal programs and consolidate reporting requirements.

Tax reductions made in fulfillment of the required local commitment would be disregarded in determining State or local government eligibility for any other assistance under any Federal law.

8. Sense of Congress with respect to designation of foreign trade zones

The bill provides that, whenever possible, foreign trade zones would be established within the enterprise zone. With respect to applications for designation of an enterprise zone as a foreign trade zone, the Foreign Trade Zone Board would expedite the application process, in which it would consider current economic development within the zone and the development anticipated as a result of the incentives in the bill.

B. Tax Incentive Provisions (Title II of the Bill)

1. Refundable tax credit for employers

Present Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of the employees. There are two provisions, the targeted jobs tax credit and the WIN tax credit which allow credits against tax for a portion of wage payments made to certain types of employees.

Targeted jobs tax credit

The targeted jobs tax credit, which applies to eligible wages paid before January 1, 1982, is available on an elective basis for hiring individuals from one or more of seven target groups. The target groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 to 25; (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income recipients; (5) general assistance recipients; (6) cooperative education students; and (7) economically disadvantaged former convicts.

The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of qualified second-year wages. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. The employer's deduction for wages is reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program. Moreover, an employer may not claim credit for wages paid to an individual for whom a WIN tax credit is claimed. Finally, qualified first-year wages for all targeted employees may not exceed 30 percent of FUTA wages for all employees.

The credit may not exceed 90 percent of the employer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward seven years.

WIN tax credit

Taxpayers are allowed, in the case of trade or business employment, a WIN tax credit equal to 50 percent of qualified first-year wages and 25 percent of qualified second-year wages paid to WIN (Work Incentive Program) registrants and AFDC recipients. For non-trade on business employment, the credit is 35 percent of up to $12,000 per employer of qualified first-year wages.

No more than $6,000 of wages during either the first or second year of employment may be taken into account with respect to any individual. Thus, the maximum credit per individual employed in a trade or business is $3,000 in the first year of employment and $1,500 in the second year of employment. The employer's deduction for wages is reduced by the amount of the credit.

The credit may not exceed 100 percent of tax liability. Excess credits may be carried back three years and carried forward seven years.

Explanation of Provision

Under the bill, employers would be permitted to claim, on an elective basis, a refundable tax credit (i.e., not limited to tax liability) that is equal to 5 percent of qualified wages paid during the taxable year. This credit would be available with respect to qualified wages paid or incurred prior to January 1, 2002. The credit claimed by an employer would reduce the employer's deduction for wages.

In general, qualified wages would be all remuneration for employment of "qualified employees", including the cash value of all remuneration paid in any medium other than cash treated as wages for employment tax purposes. Amounts excluded from the FUTA wage base generally would not be creditable. However, there would be no dollar limitation on wages eligible for the credit. Moreover, wages for purposes of the credit would not include amounts paid to an individual that are equal to payments received by the employer for on-the-job training of that individual under a Federally-funded program. Also, the credit would not be available for wages paid to an individual with respect to whom the employer has claimed a WIN tax credit or targeted jobs tax credit.

To be a "qualified employee", for purposes of the credit, an individual would have to meet two requirements. First, the individual would have to be eligible under the Comprehensive Employment and Training Act (specifically, under parts B or D of title II of CETA, dealing with general training programs and public service employment programs, respectively, or under parts A or B of title IV of CETA, dealing with youth employment programs and the job corps, respectively). Second, the individual would have to perform at least 50 percent of his services within an "enterprise zone." (See definition of an enterprise zone in part II.A., above.)

The Treasury Department would be given the authority to issue regulations dealing with special problems, such as allocation of the credit among controlled groups of corporations, in a manner similar to the way in which those problems are dealt with under the targeted jobs tax credit.

Effective Date

The provision would be effective for wages paid after the date of enactment in taxable years ending after such date.

2. Refundable credit for employees

Present Law

Under present law, the tax liability of an employee working in the United States generally does not vary according to the location of the employment. However, a refundable credit, the earned income credit, is allowed to certain low-income families with children.

Under the earned income credit, taxpayers living with children in the United States are eligible for a refundable tax credit equal to 10 percent of the first $5,000 of earnings. The maximum credit is $500. The credit phases out at a rate of 12.5 percent (*i.e.*, a reduction of 12½ cents for each additional dollar of income) as income (earned income or adjusted gross income, whichever is greater) rises above $6,000. Thus, no credit is available for families with incomes of $10,000 or more.

The earned income credit may be received in the form of advance payments added to employees' paychecks.

Explanation of Provision

Under the bill, qualified employees would be entitled to claim a refundable tax credit equal to 5 percent of qualified earned income. The maximum credit for any taxable year would be $1,500.

For purposes of the credit, a qualified employee would be an individual who is employed by a qualified business and who performed at least 50 percent of his services for that business in an enterprise zone. (See item 3 below for definition of a qualified business.)

Earned income, for purposes of this credit, would be the same as earned income for purposes of the earned income credit. That is, generally, it would be wages, salaries, tips, and other employee compensation, plus net earnings from self-employment. Earned income qualifying for the credit ("qualified earned income") would be earned income attributable to services performed for a qualified business, in an enterprise zone, during the 36-month period beginning on the date the qualified employee first performed services for any qualified business in any enterprise zone.

Qualified employees would be able to elect advance payment of the credit. The credit would not apply to qualified earned income attributable to services performed after December 31, 2001.

Effective Date

The provision would be effective for taxable years ending after the date of enactment.

3. Elimination of capital gains taxation

Present Law

Overview

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. For this purpose, the term "capital asset" generally means property held by the taxpayer. However, capital assets do not include (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) short-term government obligations, or (6) certain U.S. publications.

In addition, gains from sales or exchanges of certain depreciable or real property used in the taxpayer's trade or business may be treated as capital gains under certain circumstances.

Present law generally does not categorize gains or losses with regard to the location of an asset, or the specific purpose for which it is used.[1] In specific instances, however, present law allows nonrecognition, or rollover, of gain or loss from certain property, such as owner-occupied housing, to the extent that the proceeds are reinvested in an approved manner. In addition, present law treats some capital gain as ordinary income to the extent of certain previously taken deductions, e.g., depreciation recapture.

Capital gains deduction

Noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a taxpaver's entire net capital gain is 28 percent, i.e., 70 percent (the highest individual tax rate) times the 40 percent of the entire net capital gain includible in gross income.[2]

Corporate capital gains tax

An alternative tax rate of 28 percent applies to a corporation's net capital gain (the excess of net long-term capital gain over net short-term capital loss) if the tax computed using that rate is lower than the

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[1] UP to $50,000 ($100,000 in the case of a joint return) of losses on certain small business stock is treated as ordinary, rather than a captial, losses (Code sec. 1244).

[2] The Senate Finance Committee amendment to H.J. Res. 266 would reduce the highest individual income tax rate to 50 percent. As a result, the highest capital gains tax rate for individuals would be 20 percent, i.e., 50 percent (the highest individual tax rate under the amendment) times the 40 percent of the entire net capital gain includible in gross income.

corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Minimum taxes

"Add-on" minimum tax

Present law imposes an "add-on" minimum tax on certain specified tax preference items. Accelerated depreciation on real property is a tax preference item for all taxpayers. Accelerated depreciation on leased personal property is a tax preference item for noncorporate taxpayers, and 18/46ths of a corporation's net capital gain is a tax preference subject to the minimum tax.

Alternative minimum tax

Under present law, an alternative minimum tax is payable by noncorporate taxpayers to the extent that it exceeds their regular income tax, including the "add-on" minimum tax. The alternative minimum tax is based on the sum of the taxpayer's gross income, reduced by allowed deductions, and increased by two tax preference items: (1) "excess" itemized deductions and (2) the capital gains deduction. The alternative minimum tax rate is 10 percent for amounts from $20,000 to $60,000; 20 percent for amounts from $60,000 to $100,000; and 25 percent for amounts over $100,000.[3]

Explanation of Provision

Qualified property and qualified business

The bill would provide special tax treatment for gains and losses from sales or exchanges of "qualified property." For this purpose, the term "qualified property" would mean (1) tangible personal property acquired after the designation of an area as an enterprise zone and which was used predominantly by the taxpayer in such a zone in the active conduct of a trade or business, (2) real property acquired after the designation of an area as an enterprise zone and which was used predominantly by the taxpayer in the active conduct of a trade or business, and (3) any interest in a corporation, partnership, or other entity if, for the most recent taxable year of the entity ending before the date of acquisition of the interest, the entity was a "qualified business."

Under the provision, the term "qualified business" would mean any person (1) which is actively engaged in the conduct of a trade or business during the taxable year, (2) with respect to which at least 50 percent of such person's gross receipts for the taxable year will be attributable to the active conduct of a trade or business within an enterprise zone, and (3) with respect to which at least 40 percent of any employees hired by such person after the date on which either the person begins the active conduct of a trade or business, or any area in which the person is actively engaged in the conduct of a trade or a business is designated as an enterprise zone, are qualified employees. (See part item 1, above, for definition of a qualified employee.)

The provisions of the bill generally would not allow an already established business to be eligible for classification as a qualified business simply because it was located in an area which subsequently was des-

[3] The Senate Finance Committee amendment to H.J. Res. 266 would reduce the highest alternative minimum tax rate to 20 percent for amounts over $60,000.

ignated as an enterprise zone. However, an exception would be provided for such active trades or businesses if their average number of employees (determined on a full-time basis) during the taxable year is at least 10 percent greater than the average number of such employees during the taxable year preceding the designation of an area as an enterprise zone.

Certain low-income rental property located within an enterprise zone would also be qualified property, and the ownership of such property would be treated as the active conduct of a trade or business for purposes of the enterprise zone income exclusion (described in item 4, below). These special rules would apply to property which is described in the depreciation recapture provisions of present law relating to low-income housing (sec. 1250(a)(1)(B)(i)–(iv)), or similar property designated by the Secretary of Housing and Urban Development, and would be restricted to such property that is located in an enterprise zone, and either was constructed subsequent to the area's designation as an enterprise zone or was rehabilitated after such a designation at a cost of at least $10,000 per unit with respect to each project. If the project was financed from a State or local agency, and such agency certifies that no person is in default with respect to such financing at the time of the rehabilitation, the $10,000 per unit rehabilitation cost requirement would be reduced to $3,000.

Under the bill, the special tax treatment for gains and losses from sales or exchanges of "qualified property" would not cease to be available subsequent to the termination of an area's designation as an enterprise zone. However, the special tax rules would not apply after the first sale or exchange of any item of "qualified property" after the designation of an area as an enterprise zone ceases to apply.

Capital gains deduction

The bill would provide a special rule for a noncorporate taxpayer's gains and losses from sales or exchanges of qualified property. Under this rule, a noncorporate taxpayer could deduct from gross income an amount equal to the sum of (1) 100 percent of the lesser of: the taxpayer's net capital gain, or the net capital gain taking into account only sales or exchanges of qualified property, plus (2) 60 percent of the excess (in any) of the net capital gain over the amount of the net capital gain subject to the 100 percent deduction. This rule, in effect, would allow a noncorporate taxpayer to deduct from gross income 100 percent of any net capital gain from qualified property.

Corporate capital gains tax

The bill, in effect, would allow a corporation to exclude from taxation net capital gains from qualified property.

Minimum taxes

The bill would eliminate the minimum tax and alternative minimum tax classification of net capital gains from qualified property as a tax preference item. It also would eliminate the tax preference classification of accelerated depreciation on real property that is qualified property.

Effective Date

The capital gain changes would apply to sales or exchanges after December 31, 1981, in taxable years ending after that date.

4. Reduction in taxation of gross income of business

Present Law

Under present law, the Federal income tax liability of individuals and businesses located in the United States generally does not vary according to the location of the business within the United States. However, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income. To qualify for the credit, the corporation must derive 80 percent or more of its gross income for the three immediately preceding years from sources within Puerto Rico or a possession of the United States and it must derive at least 50 percent of its gross income for that period from the active conduct of a trade or business within those countries. If a corporation meets these requirements, it is allowed a credit equal to the U.S. tax attributable to the corporation's trade or business related income derived from Puerto Rico or the possession.

Explanation of Provision

The bill would provide an exclusion of a portion of certain gross receipts from that part of a taxpayer's taxable income which is attributable to the taxpayer's active conduct of a trade or business within an enterprise zone. This exclusion would apply to taxable years beginning after 1980 and before 2002.

The amount excluded would be determined by multiplying the applicable percentage times the sum of—

(1) receipts of a taxpayer's qualified business that are attributable to the active conduct of a trade or business within an enterprise zone, and

(2) interest received on financing (other than refinancing) that is provided by a taxpayer to a qualified business for conduct of a trade or business within an enterprise zone.

The applicable percentage for a taxable year would be as follows:

If the taxable year begins in:	*The applicable percentage is:*
1981–1997	50
1998	40
1999	30
2000	20
2001	10

For purposes of determining the amount of gross receipts excluded and the amount of taxable income from which such gross receipts would be excluded, the terms "enterprise zone" and "qualified business" have the same meanings as they do elsewhere in the bill. (See parts II.A. and II.B.3., respectively.)

Effective Date

This provision would apply to taxable years beginning after 1980 and before 2002.

5. Cash accounting for small business

Present Law

Under the cash method of accounting, taxpayers generally must deduct all expenditures other than those for capital assets. However, if a taxpayer other than a farmer has inventories, he may not use the cash method but must use the accrual method of accounting for those inventories. Under the accrual method, the taxpayer may deduct only the cost of those goods that were actually sold in the year. Thus, taxpayers may not take a deduction for goods that were purchased but not sold during the year.

Explanation of Provision

The provision would allow any qualified business (as defined in item 3, above) which has not had gross receipts in any prior taxable year of more than $2 million to elect to use the cash method of accounting for its inventories. Thus, it could deduct goods purchased, but not sold, in that year.

Effective Date

This provision would be effective for any taxable year beginning after the date of enactment.

6. Extension of net operating loss carryovers

Present Law

Under existing law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 7 years and thus may be deducted from income attributable to the other taxable years within this period.[1]

[1] The carryforward period generally would be extended to 10 years under an amendment to current law included in the Economic Recovery Tax Act of 1981, as reported by the Senate Finance Committee (H.J. Res. 266).

Explanation of Provision

For any taxable year during which a taxpayer satisfies the definition of a "qualified business" (see item 3, above), the bill would extend to 20 years the period that a net operating loss could be carried forward.

Effective Date

The provision would apply to taxable years beginning after the date of enactment.

7. Investment tax cerdit for low-income rental housing

Present Law

Under present law, a 10-percent regular investment tax credit applies to eligible property used in a trade or business or for the production of income. Certain energy property is entitled to an additional credit. Further, up to an additional one and one-half percent credit is available if certain requirements concerning employee stock ownership plans are met.

Property eligible for investment credits includes (1) tangible personal property, and (2) other tangible property used as an integral part of certain activities, such as manufacturing and production. In general, buildings and their structural components are ineligible. However, certain single purpose agricultural structures and the cost of rehabilitating a building that is at least 20 years old (rehabilitation expenditures) are eligible for investment credits. In general, property is not eligible if it is used for furnishing lodging or used in connection with furnishing lodging.

Under present law, rehabilitation expenditures for low-income rental housing may be amortized over a 60-month period, in place of the depreciation deductions which are otherwise applicable. Also, for subsidized low-income rental housing, the amount of depreciation subject to recapture as ordinary income when the property is sold is phased out by one percentage point for each month after the property has been held for 100 months.[1]

Explanation of Provision

The bill would extend eligibility for the regular 10-percent investment tax credit to certain low-income rental housing, thus creating an exception from the general rule denying the investment credit for real property and property used for lodging. Eligible low-income housing would have to be located in an enterprise zone and constructed after the area has been designated an enterprise zone. If the property were rehabilitated, rehabilitation costs would qualify for the credit if incurred after designation of the area as an enterprise zone and if the cost of rehabilitation were at least $10,000 per unit with respect to each project (or $3,000 per unit for certain property financed by a State or local agency).

Effective Date

The provision would apply to property acquired, constructed, or reconstructed after the date of enactment.

[1] Under the Economic Recovery Tax Act of 1981, as reported by the Senate Finance Committee on July 6, 1981, as an amendment to H.J. Res. 266. these special benefits would remain available for low-income housing. That bill also revises the rules relating to rehabilitation tax credits. Under that bill, credits would be available, at varying percentages, for buildings that are at least 30 years old or are certified historic structures.

8. Simplified IRS administration

Present Law

In the past, the tax law has imposed various simplification requirements. For example, the Tax Reform Act of 1976 required the Joint Committee on Taxation to conduct a study of simplification of the tax law.[1] In addition, the Revenue Act of 1978 required the Treasury Department to conduct a study of simplification of income tax forms and instructions.[2]

Under present law, one of the duties of the Joint Committee on Taxation is to investigate measures and methods for the simplification of the tax laws (Code sec. 8022(2)).[3]

Explanation of Provision

The bill would provide that it is the sense of the Congress that the Internal Revenue Service should, in every way possible, simplify the administration and enforcement of the tax provisions added to the Internal Revenue Code by this bill.

Effective Date

The provision would be effective upon enactment.

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[1] Sec. 507 of P.L. 94–455. The report, *Issues in Simplification of the Income Tax Laws*, was submitted in September 1977.

[2] Sec. 551 of P.L. 95–600.

[3] For example, at the request of the Joint Committee, the U.S. General Accounting Office conducted a study on simplification of income tax forms and issued a report entitled *Further Simplification of Income Tax Forms and Instructions Is Needed and Possible* (GAO Report No. GGD–78–74; July 5, 1978). The General Accounting Office has conducted numerous other tax administration studies in recent years for the Joint Committee and other congressional committees.

C. Regulatory Flexibility (Title III of the Bill)

Present Law

Chapter 6, Title 5, United States Code (popularly referred to as the Regulatory Flexibility Act) relates to the analysis of regulatory functions. In general, the purpose of the Regulatory Flexibility Act is to require Federal agencies to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this principle, agencies are required to solicit and consider flexibile regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration. The Act requires that special attention is to be given to small entities. For example, in its initial regulatory flexibility analysis, an agency must describe the impact of a proposed rule on small entities.

Small entities, for purposes of the Regulatory Flexibility Act, are small businesses (generally independently owned and operated business enterprises that are not dominant in their fields of operation), small organizations (independently owned and operated not-for-profit enterprises that are not dominant in their fields), and small governmental jurisdictions (governments of cities, towns, townships, villages, school districts, or special districts, with populations of less than fifty thousand).

Explanation of Provision

The bill would expand the definition of a small entity , for purposes of the Regulatory Flexibility Act, to include any qualified business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterprise operating within the zone.

For the purposes of this provision, a qualified business would be defined as it would be for other purposes of the bill.

Effective Date

The provision would be effective upon enactment.