DESCRIPTION OF MISCELLANEOUS TAX PROPOSALS

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON SELECT REVENUE MEASURES

of the

COMMITTEE ON WAYS AND MEANS

on October 12, 1989

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

October 6, 1989

JCX-62-89

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of miscellaneous tax proposals scheduled for a hearing before the House Ways and Means Subcommittee on Select Revenue Measures on October 12, 1989.

The provisions scheduled for the hearing are issues raised by Members during the Committee's consideration of revenue reconciliation, and which were deferred pending Subcommittee hearing on the provisions.

A second Subcommittee hearing is to be scheduled on October 26, 1989, on additional miscellaneous tax issues.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Miscellaneous Tax Proposals (JCX-62-89), October 6, 1989.

DESCRIPTION OF PROPOSALS

A. Transition Relief Proposals

1. Transition Rules Related to the Tax Reform Act of 1986

a. Huntsville bonds

Present Law

Federal guarantee

Interest is not tax exempt on any obligation that is federally guaranteed. This rule applies to all obligations that are issued by or on behalf of States and their political subdivisions or that are otherwise described in Code section 103. An obligation is treated as federally guaranteed if (1) the payment of the principal of, or interest on, the obligation is guaranteed, in whole or in part, by the United States or any agency or instrumentality thereof; (2) a significant portion of the proceeds of the issue of which the obligation is a part is to be used in making loans or other investments the payments on which are guaranteed in whole or in part by the United States or any agency or instrumentality thereof; (3) a significant portion of the proceeds of the issue is to be invested, directly or indirectly, in federally insured deposits or accounts in a financial institution; or (4) the payment of the principal of, or interest on, the obligation is otherwise indirectly guaranteed, in whole or in part, by the United States or an agency or instrumentality thereof.

Volume cap

The annual private activity bond volume limitation for each State is equal to the greater of (1) $50 for every individual who is a resident of the State (as determined by the most recent estimate of the State's population released by the Bureau of Census before the beginning of the calendar year to which the limitation applies) or (2) $150 million.

Bonds subject to the State private activity bond volume limitations include most private activity bonds for which tax-exemption is permitted and the private use portion (in excess of $15 million) of governmental issues. Specifically, the volume limitation applies to (1) exempt facility bonds (other than bonds for airports, docks and wharves, and certain governmentally owned solid waste disposal facilities), (2) qualified mortgage bonds, (3) qualified small issue bonds, (4) qualified student loan bonds, and (5) qualified redevelopment bonds. Certain other private activity bonds for which tax exemption specifically is provided in non-Code provisions also are subject to the private activity bond volume limitations.

<u>Advance refunding</u>

Generally the interest on any bond (issued as part of an issue) to advance refund any private activity bond is not tax exempt. An exception is provided for qualified 501(c)(3) bonds.

Explanation of Proposal

The proposal would grant an exception from the Federal guarantee and State volume cap for certain solid waste disposal facility bonds to be issued by the City of Huntsville, Alabama a portion of the security for which is a steam sales contract with the U.S. Army. Also, the proposal would treat these bonds, which will refinance certain taxable bonds used originally to finance a specified solid waste disposal facility, as qualified exempt facility bonds under Code sec. 142. Finally, the proposal would provide an exception for these bonds from the advance refunding rules.

Effective Date

The proposal would be effective on date of enactment.

b. Extension of ACRS placed-in-service date for certain property

Present Law

The Tax Reform Act of 1986 modified the depreciation deductions allowed under the accelerated cost recovery system for property placed in service after December 31, 1986. The 1986 Act, however, provided exceptions to this general effective date for certain transition property. Under these exceptions, the transition property generally must be placed in service by a prescribed date that is based on the class life of the property.

In the case of a property with a class life of at least 7 years but less than 20 years, the property generally must be placed in service by January 1, 1989. In the case of transition property with a class life of 20 or more years, the property generally must be placed in service by January 1, 1991. For this purpose, any property included in a taxpayer-specific transition rule is treated as property with a class life of 20 years, and, consequently, the property generally must be placed in service by January 1, 1991, in order for the property to qualify for transition relief.

Explanation of Proposal

The proposal would extend the date by which certain transition property with a class life of 20 or more years must be placed in service in order for the property to qualify for the more favorable depreciation deductions allowed under the accelerated cost recovery system as in effect before the 1986 Act.

First, if (1) the construction of transition property with a class life of 20 or more years began before July 13, 1988, (2) during construction the property was substantially destroyed as a result of an act of God, and (3) the Treasury Department determines that, based on all the facts and circumstances, an extension of the date by which the property must be placed in service is warranted, the Treasury Department would be authorized to extend the placed-in-service date for the property by a period that is not to exceed 2 years.

Second, if (1) the receipt of Federal funding to be used directly for a project was essential to the economics of the project such that the construction of the project could not commence without such funding, (2) an application for all or a portion of the Federal funding for the project was filed before March 1, 1986 (the general date by which the 1986 Act required a binding contract or construction to have commenced in order for property to qualify as transition property), and (3) final approval or preliminary approval of the funding for the project was granted by the applicable Federal agency before October 1, 1988, the placed-in-service date for transition property that is an integral part of such project and that has a class life of 20 or more years would be extended by 3 years.

Effective Date

The proposal would be effective as if included in the Tax Reform Act of 1986.

c. Extension of ITC and ACRS placed-in-service date for certain property

Present Law

The Tax Reform Act of 1986 modified the depreciation deductions allowed under the accelerated cost recovery system for property placed in service after December 31, 1986. In addition, the 1986 Act repealed the regular investment tax credit for property placed in service after December 31, 1985. The 1986 Act, however, provided exceptions to these general effective dates for certain transition property. Under these exceptions, the transition property generally must be placed in service by a prescribed date that is based on the class life of the property.

In the case of transition property with a class life of at least 7 years but less than 20 years, the property generally must be placed in service by January 1, 1989. In the case of transition property with a class life of 20 or more years, the property generally must be placed in service by January 1, 1991. For this purpose, all property included in a taxpayer-specific transition rule is treated as property with a class life of 20 years, and, consequently, the property must be placed in service by January 1, 1991, in order for the property to qualify for transition relief.

Explanation of Proposals

Proposal (1)

The first proposal would extend by one year (from January 1, 1991, to December 31, 1991) the date by which property that is an integral part of a specific paper mill project must be placed in service in order for the property to qualify for (1) the investment tax credit and (2) the more favorable depreciation deductions allowed under the accelerated cost recovery system as in effect before the 1986 Act.

Proposal (2)

The second proposal would extend for an unspecified period the date by which property that is an integral part of a specific cogeneration facility must be placed in service in order for the property to qualify for (1) the investment tax credit and (2) the more favorable depreciation deductions allowed under the accelerated cost recovery system as in effect before the 1986 Act.

Effective Date

The proposals would be effective as if included in the Tax Reform Act of 1986.

d. Additional transitional relief from disallowance of interest received on debt used to purchase or carry tax-exempt obligations used to finance national headquarters of certain exempt organizations

Present Law

The Tax Reform Act of 1986 denied banks, thrift institutions, and other financial institutions a deduction for that portion of the taxpayer's otherwise allowable interest expense that is allocable to tax-exempt obligations acquired by the taxpayer after August 7, 1986. In the case of tax-exempt obligations acquired by the taxpayer after December 31, 1982, and before August 8, 1986, only a percentage (generally 20 percent) of such portion of the otherwise allowable interest expense is disallowed.

The Internal Revenue Service has taken the position that the waiver by a debt holder of an interest rate adjustment clause[2] is treated as an exchange of the obligations for newly issued debt obligations. Rev. Rul. 87-19, 1987-1 C.B. 249.

Explanation of Proposal

The proposal would treat a waiver of a interest rate adjustment clause by the holder of certain tax-exempt obligations as not being an exchange of the obligation for a newly-issued obligation for purposes of the effective date of the 1986 Reform Act. The proposal would apply to tax-exempt obligations issued to finance the national headquarters of certain tax-exermpt organizations. The effect of adoption of the proposal would be to disallow only 20 percent of the interest deductions of the bank that hold such obligations instead of the 100 percent disallowance provided by the 1986 Reform Act.

Effective Date

The proposal would be effective as if included in the Tax Reform Act of 1986.

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[2] Privately placed tax-exempt obligations commonly contain a provision that adjusts the rate of interest on the obligation if the benefit of the tax-exempt status of the interest is affected by subsequent legislation (e.g., the tax rate of the debt holder is reduced or the interest deductions of the debt holder are reduced).

e. $2 million exclusion from generation-skipping transfer tax (sec. 1433(b)(3) of the Tax Reform Act of 1986)

Present Law

The Tax Reform Act of 1986 imposed a generation-skipping transfer tax on transfers by gift or bequest to persons two or more generations below the transferor. A person may transfer $2 million to a grandchild prior to January 1, 1990, without incurring this tax (the "$2 million exclusion"). A transfer to trust will qualify for the $2 million exclusion only if certain requirements are met, including annual distribution of trust income to the grandchild after age 21 (the "distribution requirement").

Explanation of Proposals

Proposal (1)

The $2 million exclusion would be allowed for transfers to step-grandchildren.

Proposal (2)

The distribution requirement would be modified to require that annual distribution of income only after age 25. Alternatively, the effective date for the requirement could be modified.

Effective Date

The proposals would be effective for transfers made after October 22, 1986.

f. Small business exemption from recognition of gain or loss on liquidating sales or distributions (exemption from repeal of the General Utilities doctrine)

Present Law

Gain or loss is generally recognized by a corporation on a liquidating sale or distribution (including a deemed sale occurring when a corporation is acquired and an election is made to treat the transaction as an asset sale). This rule was added to the Code by the Tax Reform Act of 1986. Prior to the 1986 Act, gain was generally recognized in the case of nonliquidating sales or distributions but not in the case of liquidating sales (including sales involving the acquisition of the corporation). However, certain nonliquidating distributions to long-term individual shareholders were not taxed prior to the 1986 Act. The 1986 Act generally conformed the treatment of gain in liquidating sales and distributions to the treatment that resulted in the absense of a liquidation or an acquisition by requiring gain recognition in all cases.

The 1986 Act provided transition relief for certain small corporations. Corporations eligible for this relief were granted two additional years, until December 31, 1988, in which they could distribute assets, liquidate, or convert to subchapter S status without becoming subject to the 1986 Act provision except in the case of ordinary income assets or capital assets held less than six months, or in the case of certain conduit transactions with ineligible corporations.

Eligible corporations were those in existence on August 1, 1986, and whose value on the later of that date or the date of adoption of a plan of liquidation did not exceed $10 million, provided that on August 1, 1986 and at all times thereafter, more than 50 percent (by value) of the stock of such corporation was owned by a qualified group. This was a group of 10 of fewer individuals who at all times during the five year period ending on the date of adoption of the plan of liquidation (or during the life of the corporation, if shorter) owned more than 50 percent of the value of the corporate stock. Corporations whose value exceed $5 million were eligible only for partial relief and the relief was phased out entirely at a size of $10 million.

Explanation of Proposal

The 1986 Act relief from gain recognition for small corporations that expired at the end of 1988 would be made permanent. Appropriate conforming changes to the definition of short-term capital assets would be made to reflect changes in the definition of such assets since 1986.

Effective Date

The provision would be effective for distributions or sales occurring after December 31, 1988.

g. Treatment of nonprofit health insurance providers

Present Law

The Tax Reform Act of 1986 added a rule that an organization described in sections 501(c) and (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance(section 501(m)). The 1986 Act provided special rules for certain health insurance providers subject to this provision. In particular, the 1986 Act provided a special deduction for then-existing Blue Cross or Blue Shield organizations and other organizations that meet certain requirements and substantially all of whose activites are providing health insurance.

The special deduction (section 833) is provided to such organizations with respect to their health business equal to 25 percent of the claims and expenses incurred during the taxable year less the adjusted surplus at the beginning of the year. This deduction is calculated by computing surplus, taxable income, claims incurred, expenses incurred, tax-exempt income, net operating loss carryovers, and other items attributable to health business. The deduction may not exceed taxable income attributable to health business for the year (calculated without regard to this deduction).

In addition, the 1986 Act provided special rules for determining the accounting method, unearned premium reserves, and asset basis of such organizations, relating to their former tax exempt status.

Explanation of Proposal

The proposal would provide the section 833 deduction to the same extent it is provided under present law to certain existing Blue Cross or Blue Shield organizations, in the case of a Blue Cross or Blue Shield-type organization existing on August 16, 1986 and otherwise meeting the requirements for the section 833 special deduction. Under the proposal, a Blue Cross or Blue Shield-type organization would include (but would not be limited to) an organization other than a health maintenance organization that is organized under and governed by state laws which are specifically and exclusively applicable to not-for-profit health insurance or health service type organizations.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1989.

h. Exemption for certain Blue Cross and Blue Shield organizations (H.R. 2191)

Present Law

The Tax Reform Act of 1986 added a rule that an organization described in sections 501(c) and (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance (section 501(m)). The 1986 Act provided special rules for certain health insurance providers subject to this provision. In particular, the 1986 Act provided a special deduction for then-existing Blue Cross or Blue Shield organizations and other organizations that meet certain requirements and substantially all of whose activities are providing health insurance.

The special deduction (section 833) is provided to such organizations with respect to their health business equal to 25 percent of the claims and expenses incurred during the taxable year less the adjusted surplus at the beginning of the year. This deduction is calculated by computing surplus, taxable income, claims incurred, expenses incurred, tax-exempt income, net operating loss carryovers, and other items attributable to health business. The deduction may not exceed taxable income attributable to health business for the year (calculated without regard to this deduction).

In addition, the 1986 Act provided special rules for determining the accounting method, unearned premium reserves, and asset basis of such organizations, relating to their former tax-exempt status.

Explanation of Proposal

Under the proposal, the rule of section 501(m) (that certain organizations are exempt from tax only if no substantial part of their activities consists of providing commercial-type insurance) would not apply to organizations meeting certain requirements. The requirements would include the following: (1) substantially all the activities of the organization involve the providing of health insurance and the administration, adjustment and settlement of claims under health business; (2) at least 10 percent of such health insurance is provided to individuals and small groups; (3) continuous full-year open enrollment is provided; (4) coverage of high-risk individuals is provided in accordance with certain requirements; (5) individual and small group premiums are community rated; (6) no part of the net earnings inures to the benefit of any private shareholder or individual; (7) at least 85 percent of premiums earned are returned in its individual, small group and medicare supplemental business; (8) the organization qualifies as tax-exempt under state and local tax law (except property tax) and is subject to State regulation of premiums and reserves; and

(9) certain conversion options are provided to individuals leaving a group plan.

In addition, the special deduction provided under section 833 would be repealed.

The proposal was introduced as H.R. 2191 by Mr. Rangel, with Messrs. Downey, McGrath, Lent, McHugh, Gilman, Towns and Manton cosponsoring.

Effective Date

The effective date of H.R. 2191 is taxable years after December 31, 1988, for the exception to section 501(m), and taxable years beginning after December 31, 1991, for the repeal of the section 833 special deduction. Alternatively, the proposal could be made effective for taxable years beginning after December 31, 1989.

i. Harlem International Trade Center bonds

Present Law

The Tax Reform Act of 1986 restricted the availability of private activity tax-exempt bond financing. While convention and trade show facilities could be financed as qualified industrial development bonds (IDBs) under prior law, they no longer fall within any category of exempt facility bonds eligible for tax-exemption under present law. The 1986 Act also provided limited transition relief to allow tax-exempt financing for certain convention and trade show facilities. Such relief was afforded bonds to finance the Harlem International Trade Center if issued before December 31, 1990.

Under both prior and present law, to qualify for tax exemption, bonds issued to finance convention or trade show facilities must be for special-purpose buildings or structures. Treas. Reg. sec.1.103-8(d)(2). That requirement has been interpreted to prohibit the financing of facilities which are an integral part of a hotel. See, e.g., Rev. Rul. 85-94, 1985-2 C.B. 33.

Explanation of Proposal

The convention and trade show facilities in question will be part of a larger building also containing hotel and office facilities, thus raising an ambiguity as to whether the regulation could be complied with. The proposal would extend the effective date of the Harlem International Trade Center transition relief to bonds issued prior to July 1, 1993. The proposal would also provide that the bonds are tax-exempt regardless of whether they finance all or a portion of the facility.

Effective Date

The proposal would be effective on the date of enactment.

j. Sports facilities bonds

Present Law

The Tax Reform Act of 1986 restricted the availability of private activity tax-exempt bond financing. Specifically, the volume limitation applies to (1) exempt-facility bonds (other than bonds for airports, docks and wharves, and certain governmentally owned solid waste disposal facilities), (2), qualified mortgage bonds, (3) qualified small-issue bonds, (4) qualified student loan bonds, and (5) qualified redevelopment bonds. Certain other private activity bonds for which tax exemption specifically is provided in non-Code provisions also are subject to the private activity bond volume limitations. While sports stadiums and convention facilities could be financed as qualified industrial development bonds (IDBs) under prior law, they no longer fall within any category of exempt facility bonds eligible for tax-exemption under present law.

The 1986 Act did provide limited transition relief which allows tax-exempt bond financing for certain sports stadium and convention facilities. However, the 1986 Act did not include exceptions from the State volume cap for such bonds. The annual private activity bond volume limitation for each State is equal to the greater of (1) $50 for every individual who is a resident of the State (as determined by the most recent estimate of the State's population released by the Bureau of Census before the beginning of the calendar year to which the limitation applies) or (2) $150 million.

Explanation of Proposal

The proposal would provide an exception from the State private activity bond volume limitation for certain bond issues. The exception from the volume cap would be extended only to sports stadium and convention facility bonds: (1) issued under transition relief included in section 1317(3)(F) of the Tax Reform Act of 1986, and (2) which have not received an allocation of volume cap prior to the effective date of this proposal.

Effective Date

The proposal would be effective on the date of enactment.

k. Treatment of certain compensation payable by certain personal service corporations using an accrual method of accounting

Present Law

Under the Tax Reform Act of 1986, a personal service corporation that uses an accrual method of accounting generally is not allowed a deduction for an amount payable to an employee-owner of the corporation prior to the time that the amount is includible in the gross income of the employee-owner. For this purpose, a personal service corporation is any corporation the principal activity of which is the performance of personal services if the services are substantially performed by employee-owners and more than 10 percent of the value of the outstanding stock of the corporation is owned by employee-owners. An employee-owner is any employee of the corporation who owns any of the outstanding stock of the corporation (generally determined by applying the attribution rules of section 318).

Explanation of Proposal

A qualifying personal service corporations that uses an accrual method of accounting would be allowed a deduction for a limited amount of compensation that is payable to an employee-owner of the corporation at the time that the compensation would otherwise have been deductible in the absence of the 1986 Act provision that postpones the deduction until the time that the compensation is includible in the gross income of the employee-owner.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1988.

2. Transitional Relief to Other Acts

a. Hydroelectric energy project -- placed in service date

Present Law

An 11-percent tax credit was available for hydroelectric energy projects that were placed in service before January 1, 1986. For such projects which had made a timely application for certification by the Federal Energy Regulatory Commission (FERC), the credit would be allowed for a project placed in service before December 31, 1988.

In the Electric Consumers Protection Act 1986, FERC was specifically instructed by Congress to issue a license for the Island Park hydroelectric project "only if the Commission determines that significant and permanent alteration of streamflow, habitat, water temperature, and quality will not occur as a result of the project." Alterations were made in the project's plans to assure that none of the environmental damage described above would occur. FERC certification has been obtained to start construction of the project. Such authorization was given too late for the Island Park project to be completed in time to receive the hydroelectric energy tax credit.

Explanation of Proposal

The proposal would amend section 46(b)(2)(D) by substituting December 31, 1991, for December 31, 1988. The proposal, in effect, extends the placed-in-service deadline by enough time to allow the Island Park project to be completed.

Effective Date

The proposal would be effective as if included in Title II of the Tax Reform Act of 1986.

b. Municipal Assistance Corporation of the City on New York

Present Law

Private loan test

A bond (including refunding bonds) is a private activity bond if an amount exceeding the lesser of five percent or $5 million of bond proceeds is to be used (directly or indirectly) to make or finance loans to any person other than a governmental unit.

Municipal Assistance Corporation of New York

The Municipal Assistance Corporation of New York (MAC) was created to help New York City during its financial crisis. In its role of providing fiscal support MAC issued tax-exempt obligations. The proceeds of these obligations were used as a source of funds to directly and indirectly meet the obligations of the City. The City in return delivered to MAC certain City obligations which financed low- income loans to the owners of certain housing projects. This exchange would cause the refunding of the MAC bonds to satisfy the private loan test.

Explanation of Proposal

Certain bonds issued to refund the currently outstanding obligations of the Municipal Assistance Corporation of the City of New York would be to exempted from the private loan test. The proposal would apply only if the following restrictions are satisfied: (1) the proceeds of the new issue must be used exclusively for the current refunding; (2) the amount of the refunding issue may not exceed the outstanding amount of the refunded bonds; and (3) the final maturity date of the refunding issue may not be extended later than July 1, 1995.

Effective Date

The proposal would be effective on the date of enactment.

c. Transition relief from the effective date of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 for certain acquisitions of thrift institutions

Present Law

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (P.L. 101-73) (FIRREA) provided for early termination of three special tax rules applicable to financially troubled financial institutions, effective for transactions occurring on or after May 10, 1989 (the date of Ways and Means Committee action). These special tax rules provided as follows.

(1) Payments from the Federal Savings and Loan Insurance Corporation (the "FSLIC") or the Federal Deposit Insurance Corporation (the "FDIC") to a financially troubled financial institution were not included in the income of the recipient institution and such institutions need not have reduced their basis in property by the amount of such financial assistance. However, there may have been a reduction in certain tax attributes of a financially troubled financial institution equal to 50 percent of the amount of the financial assistance (Code sec. 597).

(2) Certain FSLIC- or FDIC-assisted acquisitions involving a financially troubled financial institution may have qualified as tax-free reorganizations without regard to the requirement that the shareholders of an acquired corporation must generally maintain a meaningful ownership interest in the acquiring corporation (the "continuity of interest" requirement) in order for the reorganization to be treated as tax free (Code sec. 368(a)(3)(D)).

(3) The general limitations on the ability of an acquiring corporation to utilize the net operating losses, built-in losses, and excess credits of a corporation acquired in a tax-free reorganization were relaxed in the case of a tax-free acquisition of a financially troubled financial institution (Code sec. 382(l)(5)(F)).

Explanation of Proposal

The proposal would provide that the early termination of the special tax rules for financially troubled financial institutions would not apply to mutual thrift institutions whose applications for voluntary supervisory conversion were pending before the Federal Home Loan Bank Board (FHLBB) on or before May 10, 1989, provided that (1) any such thrift institution is acquired pursuant to the voluntary supervisory conversion application pending before the FHLBB on or before May 10, 1989, and (2) no Federal financial assistance is provided with respect to such conversion or acquisition transactions.

Effective Date

The proposal would be effective on the date of enactment.

B. New Issues

1. Tax-free removal of distilled spirits from foreign trade zones

Present Law

The excise tax on imported distilled spirits ($12.50 per proof gallon) is imposed on the first removal of the distilled spirits from the first foreign trade zone to a customs bonded warehouse. Under prior law, the tax was imposed when imported distilled spirited were shipped from a bonded warehouse, to which the products had been transferred, which often would be a wholesale distributor.

The change was made from prior law in order to treat imported distilled spirits and domestic distilled spirits similarly. Since domestic distilled spirits are taxed when leaving the distillery, even to a bonded warehouse on the same grounds, it was believed that imposing the tax on imports as they leave a foreign trade zone would place importers and domestic producers on the same competitive basis.

Explanation of Proposal

The proposal would impose the tax on imported distilled spirits on the removal from the first bonded warehouse to which these products had been transferred from the foreign trade zone. The proposal effectively would restore prior law.

Effective Date

The proposal would be effective on January 1, 1990.

2. Nonconventional Fuels Tax Credit

a. and b. Modifications to, and eligibility of tight sands gas for, production credit for nonconventional fuels

Present Law

Section 29 of the Code provides for a tax credit for producing fuel from a nonconventional source. Nonconventional fuels are eligible for a production credit which is equal to $3 per barrel of BTU oil barrel equivalent. Those fuels which are eligible must be produced from a well drilled, or a facility placed in service, before January 1, 1991. Qualified fuels are eligible for the production credit through December 31, 2000.

Gas from a tight sands formation was eligible for the production credit as long as natural gas was subject to price controls, under sec. 107 of the Natural Gas Policy Act of 1978.

Explanation of Proposal

(1) Production of gas from a tight sands formation would be eligible for the production credit even though the price of natural gas no longer is subject to price control.

(2) The production credit for gas produced from a tight sands formation would be available for gas from wells drilled after July 1, 1989. Also, gas from newly spudded wells would be treated the same as gas produced from an old well, i.e., drilled prior to the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989.

(3) The production credit for nonconventional fuels would be extended to apply to wells drilled or facilities placed in service before January 1, 1993, instead of before January 1, 1991.

Effective Date

Thc proposal would be effective on January 1, 1990.

c. Tax treatment of producer of shale oil

Present Law

Section 29 of the Internal Revenue Code provides a tax credit for producing fuel from a nonconventional source. Oil produced from shale is eligible for the credit.

In addition to providing the production credit, section 29 limits the credit to the amount of excess of regular income tax (reduced by other credits) over the tentative minimum tax.

Gas generated during the shale oil production process is not eligible for the nonconventional fuels production credit. Qualified fuels are not eligible for the production credit unless sold to an unrelated person. The amount of the production credit allowed to a taxpayer is reduced by the amount of other forms of subsidy provided in the form of grants, subsidized energy financing, or through other provisions in the Internal Revenue Code, such as, tax-exempt bond financing and energy tax credits.

Explanation of Proposal

The proposal would make the following modifications:

(1) The section 29 production credit would be extended to gas produced from shale, and there would be no reduction in the allowable credit because of sales to a related person;

(2) Credits allowable for production of oil and gas from shale would be eligible for a 3-year carryback and a 15-year carryforward, subject to some limitations;

(3) The credits generated by production of oil and gas from shale would not be subject to the limitations in section 29 concerning (a) the phaseout of the credit as oil prices rise, (b) reduction of the credit if tax-exempt financing is used, and (c) the interaction with other credits; and

(4) The provisions of the tentative minimum tax concerning the credit for prior year minimum tax liability would not apply to credits generated by production of oil and gas from shale during this period.

Effective Date

The proposal would apply only with regard to oil and gas produced by retort of shale rock during taxable years beginning after December 31, 1988, and ending on or before December 31, 1991.

3. Modify treatment of certain crew members on fishing vessels

Present Law

Under present law, service as a crew member on a fishing vessel is generally excluded from the definition of employment for purposes of determining wages subject to employment taxes if (1) the individual receives no other compensation other than a share of the boat's catch, and (2) the operating crew of the boat is normally made up of fewer than 10 individuals.

Explanation of Proposal

Under the proposal, service as a crew member on a fishing vessel is treated as meeting the exclusion from the definition of employment even if, in addition to a share of the boat's catch, the individual receives an additional amount of compensation (such as the additional payment described in Situation 1 of Revenue Ruling 77-102, 1977-1 C.B. 299, or any similar payment designed to have substantially the same effect). This rule applies only if (1) the additional amount does not exceed $50 per trip, (2) payment of the amount is contingent on the attainment of some minimum level of catch, and (3) the amount is paid solely in recognition of the individual's performance of additional duties, such as those of mate, engineer, or cook, for which it is traditional in the industry to receive such additional compensation.

The proposal would modify the present-law rule regarding the maximum crew size by providing that, in general, the operating crew of the boat normally must consist of 10 or fewer individuals. This requirement is only satisfied with respect to a quarter if during the immediately preceding four quarters the boat's operating crew consisted of 10 or fewer individuals on at least 50 percent of the trips made during that period.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1989. The change from "fewer than 10" to "10 or fewer" is a change in statutory language. With respect to the other provisions of the proposal, no inference is intended with respect to the correct interpretation of present law. For example, no inference is intended with respect to the permissible method under present law of determining whether the requirement that the crew normally be made up of fewer than 10 individuals is satisfied.concerning the credit for prior year minimum tax liability would not apply to credits generated by production of oil and gas from shale during this period.

4. Providing tolerance limits for blending of gasohol

Present Law

Gasohol blenders which produce a blend containing 10 percent alcohol and 90 percent gasoline may receive a credit or refund of 6 cents per gallon of the 9 cents per gallon gasoline excise tax which is dedicated to the Highway Trust Fund.

Blenders have found in practice that it is difficult to achieve precisely the 10 percent alcohol content in a gasohol blend because of (1) mechanical imprecision in metering alcohol into a tankload of gasoline which can occur because the calibration of dispensing equipment may have become inexact during usage and (2) cut-off valves which do not respond instantaneously to mechanical or electronic signals to cease dispensing.

Explanation of Proposal

The proposal would provide several modifications in existing law and procedures.

(1) A mixture of gasoline and alcohol would be considered at least 10 percent alcohol if the mixture, determined immediately after blending, is at least 9.802 percent alcohol and no more than 25 percent of the total gallons of the mixtures of the taxpayer for the calendar quarter are less than 9.9 percent.

(2) If a gasohol blend which meets the statutory requirements under section 4081(c) immediately after blending later is combined with a fuel that does not qualify as gasohol and subjected to the Highway Trust Fund excise tax, the gasohol mixture would not become subject to the excise tax.

(3) Refund claims by a gasohol blender would be eligible for interest payment on the refund after the date of filing.

Effective Date

The proposal would be effective on January 1, 1990.

5. Withholding on certain welfare benefit funds for employment taxes (sec. 105(b))

Present Law

Under present law, an employee's gross income generally does not include payments under employer-provided health coverage (sec. 105(b)). However, this exclusion does not apply to amounts that the taxpayer is, or could become, entitled to receive without regard to whether he or she incurred expenses for health care during the period of health coverage.

Explanation of Proposal

The proposal would affirm the present-law rule that the section 105(b) exclusion does not apply to amounts that the taxpayer is, or could become, entitled to receive without regard to whether he or she incurred health care expenses during the period of health coverage. The IRS would be expected to review and revise relevant outstanding revenue rulings (such as Rev. Ruls. 65-275 and 78-392) in light of this affirmation.

In addition, the proposal would relieve a certain fund of any liability for unpaid employment taxes for periods prior to January 2, 1987, to the extent that such liability is attributable to the payment of certain supplemental unemployment benefits, vacation benefits, and health expense reimbursements.

The proposal is the same as a provision that was included in the Omnibus Budget Reconciliation Act of 1987 as reported by the Committee on the Budget of the House of Representatives.

Effective Date

The proposal would be effective on the date of enactment.