

DESCRIPTION OF TAX BILLS

(S. 1298, S. 2197, and S. 2498)

Scheduled for a Hearing
on July 19, 1982
Before the
Subcommittee on Taxation and Debt Management
of the
Senate Committee on Finance

Prepared by the Staff
of the
Joint Committee on Taxation

July 16, 1982

JCX-32-82

CONTENTS

	<u>Page</u>
Introduction-----	i
I. Summary-----	1
II. Description of Bills-----	3
1. S. 1298 (Senators Wallop, Baucus, Bradley, Packwood, and others): "The Indian Tribal Governmental Status Act-----	3
2. S. 2197 (Senators Matsunaga, Roth, Moynihan, and Durenberger): Modification and expansion of exemption for certain taxicabs from gasoline and special fuels excise taxes-----	9
3. S. 2498 (Senators Matsunaga and Durenberger): Exception for Educational organizations from certain unrelated business income provisions-----	11

INTRODUCTION

The bills described in this document are scheduled for a hearing on July 19, 1982, before the Senate Finance Subcommittee on Taxation and Debt Management. There are three bills scheduled for the hearing: (1) S. 1298 (relating to tax status of Indian tribes); (2) S. 2197 (relating to excise tax exemption for certain taxicab motor fuels); and (3) S. 2498 (relating to unrelated business income provisions for educational organizations).

The first part of the document is a summary of the bills. This is followed in the second part by a more detailed description of the bills, including present law, issues, explanation of provisions, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 1298--Senators Wallop, Baucus, Bradley, Packwood, and others

The Indian Tribal Governmental Status Act

S. 1298 would amend the Internal Revenue Code to provide to certain Indian tribal governments generally the same tax treatment in many respects that is now available to States and their political subdivisions. This series of changes would treat Indian tribal governments (the governing bodies of Indian tribes or Alaska Native villages which are recognized by the Treasury Department as exercising sovereign powers) similar to States for the purpose of determining whether they can issue tax-exempt bonds, the same as States for determining whether taxes paid to and charitable contributions made to the Indian tribal government are deductible, and the same as States for certain other income and excise tax purposes.

2. S. 2197--Senators Matsunaga, Roth, Moynihan, and Durenberger

Modification and Expansion of Exemption for Certain Taxicabs from Gasoline and Special Fuels Excise Taxes

Under present law, gasoline and special fuels used in qualified taxicabs are not subject to the general excise taxes imposed on those fuels under Code sections 4081 and 4041 respectively when used in furnishing qualified taxicab services (i.e., service in areas where taxicabs are not prohibited from ride sharing) (sec. 6427(e)). Taxicabs which are manufactured after 1978 must have a fuel economy rating in excess of the average EPA rating for the type of vehicle involved to qualify for this exemption. The exemption for qualified taxicab use is accomplished by means of a refund or credit against income tax claimed for the amount of tax originally paid on the purchase of the fuels. The present exemption is scheduled to expire on January 1, 1983.

Under the bill, the exemption for fuels used in providing qualified taxicab services would be provided at the time the fuels are purchased in the case of registered taxicab operators. In addition, the types of vehicles eligible for the exemption would be expanded to include vehicles with a fuel economy rating in excess of 75 percent of the average EPA rating for the type of vehicle involved. Finally, the bill would make this exemption from tax permanent.

3. S. 2498 - Senators Matsunaga and Durenberger

Exception for Educational Organizations From
Certain Unrelated Business Income Provisions

Under present law, generally, any qualified pension trust or organization that is otherwise exempt from Federal income tax is taxed on income from trades or businesses that are unrelated to the organization's exempt purposes. Included in unrelated business income is an exempt organization's income from "debt-financed property," which is not used for its exempt function. Debt-financed property is defined as any property which is held to produce income and with respect to which there is acquisition indebtedness at any time during the taxable year or during the 12 months prior to disposition if the property is disposed of during the taxable year. With certain exceptions, indebtedness incurred by a qualified pension trust as a result of the acquisition or improvement of real property is not considered "acquisition indebtedness." Thus, income or gain received from a qualified pension trust or with respect to such debt-financed real property is not treated as income from debt-financed property.

The bill would expand the exception for qualified pension trusts from the general definition of acquisition indebtedness to include educational organizations. Thus, income or gain received from or with respect to debt-financed real property owned by educational organizations would not be treated as income from debt-financed property.

II. DESCRIPTION OF BILLS

1. S. 1298--Senators Wallop, Baucus, Bradley, Packwood, and others

The Indian Tribal Governmental Status Act

Present Law

Overview

States (including the District of Columbia) and their political subdivisions generally are exempt from Federal tax. In addition, numerous transactions by private parties with State governments and their political subdivisions result in favorable Federal tax treatment (e.g., exclusion from gross income, tax deductions, or tax credits) for the private parties involved. Under present law, Indian tribal governments are not treated as State and local governments.

Taxation of State and local governments

State and local governments generally are exempt from the Federal income tax (Code sec. 115). In addition, State and local governments are exempt from most Federal excise taxes if an article is used exclusively for the State or local government. Among the excise taxes for which exemptions are provided are the special fuels taxes (chapter 31), the manufacturers excise taxes (chapter 32), the communications tax (chapter 33), and the highway use tax (chapter 36).

Taxation of Indian tribal governments

The Internal Revenue Code does not specifically exempt Indian tribal governments from Federal taxation; however, the Internal Revenue Service has ruled that Indian tribes are not taxable entities.^{1/} This ruling provides further that tribal income not otherwise exempt from Federal income tax is includible in the gross income of the Indian tribal member when distributed or constructively received by the individual. Since Indian tribal governments are not within the definition of "State" contained in the Code (sec. 7701(a)(10)), the excise tax exemptions provided for States do not apply to the tribal governments.

^{1/} Rev. Rul. 67-284, 1967-2 C.B. 55.

Special treatment of certain transactions involving State and local governments

Tax-exempt bonds.--Interest on obligations issued by or on behalf of State and local governments generally is exempt from Federal income tax. However, subject to certain exceptions, interest on State and local issues of industrial development bonds (IDBs) is taxable. An obligation is an IDB if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization (described in sec. 501(c)(3)), and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property or borrowed money used in a trade or business.

Present law provides an exception which exempts from tax interest on IDBs that are issued to finance certain types of exempt-purpose facilities. Present law also provides an exception to the general rule of taxability for interest paid on IDBs for certain "small issues." The interest on small issue IDBs is exempt if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property. This exception applies to issues of \$1 million or less. At the election of the taxpayer, the limitation may be increased to \$10 million, subject to certain restrictions. Finally, tax-exempt financing is permitted for student loans and organizations that qualify for tax exemption under section 501(c)(3), such as private, nonprofit hospitals and private, nonprofit educational institutions.

State and local taxes.--Certain State and local taxes are deductible for Federal income tax purposes whether or not they are paid or incurred in a business context (sec. 164). This provision applies to real property taxes, personal property taxes, income taxes, and general sales taxes. A credit against Federal estate tax is available for limited amounts of State death taxes (sec. 2011). Also, a partial credit against the Federal unemployment tax is allowed for State unemployment tax (secs. 3302-3303).

Charitable contributions.--Charitable contributions generally are deductible for income tax purposes (sec. 170). A contribution to or for the use of a State or political subdivision is a charitable contribution, but only if the contribution is made for "exclusively public purposes" (sec. 170(c)(1)). Similarly, such contributions are deductible for estate tax and gift tax purposes (secs. 2055, 2106(a)(2), and 2522).

Unrelated business income.--A tax is imposed on the unrelated business taxable income of certain types of organizations that generally are exempt from income taxation (sec. 511). Although this tax generally does not apply to State or local governments or their instrumentalities (see sec. 115), the tax does apply to colleges and universities which are agencies or instrumentalities of governments or political subdivisions or which are owned or operated by governments or political subdivisions or by their agencies or instrumentalities (sec. 511(a)(2)(B)).

Excise taxes on prohibited transactions by public charities and private foundations.--An excise tax is imposed on certain public charities that make "excess" expenditures to influence legislation. The term "legislation" is defined to include "action with respect to Acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure" (sec. 4911(e)(2)).

Present law also includes a series of restrictions on activities of private foundations, restrictions on "self-dealing," and on "taxable expenditures." The self-dealing rules generally prohibit payments to government officials, a term which includes anyone holding "elective or appointive public office" in the government of a State, a political subdivision, "or other area of any of the foregoing," if that person is receiving gross compensation at an annual rate of \$15,000 or more, and also includes a personal or executive assistant or secretary to any such officeholder. The taxable expenditure rules generally prohibit expenditures to influence legislation. Treasury regulations define "legislation" for purposes of this provision to include "action * * * by any State legislature [or] by any local council or similar governing body * * *" (Treas. Reg. §53.4945-2(a)(2)).

Credit for the elderly.--People who receive retirement income from public retirement systems and have not yet attained age 65 are entitled to credits against income tax under rules different from those applying generally to people 65 or older (sec. 37). A pension, annuity, retirement, or similar fund or system established by a State or political subdivision is a "public retirement system" under these provisions.

Eligibility for certain tax-deferred annuities.--Present law provides that an employee who performs services for an educational institution may exclude from income amounts paid by his or her employer under certain types of annuity arrangements ("tax-sheltered annuities"), if the employer is "a State, a political subdivision of a State, or an agency or instrumentality of one or more of the foregoing" (sec. 403(b)(1)(A)(ii)).

Political campaign contributions.--An individual is allowed a nonrefundable credit (sec. 41) against income tax of 50 percent of his or her political contributions and newsletter fund contributions made during the taxable year, with a maximum credit of \$50 (\$100 on a joint return). Eligible recipients of political contributions include political parties and individuals who are candidates for nomination or election to any Federal, State, or local elective public office (sec. 41). The Code defines "local" to mean "a political subdivision or part thereof, or two or more political subdivisions or parts thereof of a State."

Scholarship and fellowship grants.--Generally, scholarships and fellowships are excluded from gross income of the recipients (sec. 117). Only a limited exclusion is available in the case of a recipient who is not a candidate for a degree at an educational institution, and even that limited exclusion is available only if the grantor meets one of several tests. A State or political subdivision thereof is an eligible grantor under this provision (sec. 117(b)(2)(A)(iv)).

Special treatment of certain transactions involving Indian tribal governments

Because Indian tribal governments are not treated like State governments for tax purposes, the favorable consequences available to private parties entering into transactions with State governments generally are unavailable for those transactions entered into with the tribal governments. ^{2/} The excise taxes on certain prohibited transactions dealings by charities with State governments likewise do not apply.

Issues

The first issue is whether Indian tribal governments should be treated as State governments for Federal tax purposes and, if so, shall any exceptions be made.

The second issue is whether transactions involving Indian tribal governments should be treated as transactions involving State governments for Federal tax purposes.

^{2/} Sec. 4225 of the Code exempts from manufacturers excise tax any article of native Indian handicraft produced by Indians on Indian reservations, in Indian schools, or by Indians under the jurisdiction of the U.S. Government in Alaska.

Explanation of the Bill

Overview

The bill would provide that, for a series of specified purposes under the Internal Revenue Code, Indian tribal governments are to be treated the same as States or similar to States. The bill would define the term "Indian tribal government" to include certain governments of Alaska Natives as well as Indians and would apply whether the entity was characterized as a tribe or as a band, community, village, or group. The rules of the bill would not apply to any Indian tribal government unless it were recognized by the Treasury Department (after consultation with the Interior Department) as exercising sovereign powers. Sovereign powers include the power to tax, the power of eminent domain, and police powers (such as control over zoning, police protection, and fire protection).

The Code provisions amended by this bill generally provide that political subdivisions of States are to be treated essentially the same as the States themselves. Under the bill, a subdivision of an Indian tribal government would be treated as a political subdivision of a State for the purposes specified in the bill if (and only if) the Treasury Department determined (after consultation with the Interior Department) that the subdivision of the Indian tribal government had been delegated the right to exercise one or more of the sovereign powers of the Indian tribal government.

Taxation of Indian tribal governments

Under the bill, most Federal excise taxes would not apply to articles sold for the exclusive use of Indian tribal governments. Among the excise taxes for which exemptions would be provided are the special fuels taxes (chapter 31), the manufacturers excise taxes (chapter 32), the communications tax (chapter 33), and the highway use tax (chapter 36). The bill would not amend the present income tax treatment of Indian tribal governments specified in Rev. Rul. 67-284, *supra*. (i.e., income of the tribe is taxable when distributed to tribe members).

Special treatment of certain transactions involving Indian tribal governments

General rule.--Indian tribal governments would be treated as States in the following transactions involving private parties--

(1) The exclusion from income of interest on certain obligations of State governments (except as set forth below).



- (2) The deduction for taxes paid to State and local governments (sec. 164);
- (3) The deductions for charitable contributions (secs. 170 (income tax), 2055 and 2106 (estate tax), and 2522 (gift tax));
- (4) The tax on unrelated business income of certain types of organizations (sec. 511);
- (5) The taxes imposed on certain prohibited transactions by public charities and private foundations (secs. 4911 and 4945);
- (6) The credit for individuals who receive retirement income from public retirement systems (sec. 37);
- (7) Eligibility for certain tax-deferred annuities (sec. 403(b)(1));
- (8) The credit for political campaign contributions (sec. 41); and
- (9) The exclusion of certain scholarships and fellowships awarded to students who are not candidates for a degree (sec. 117).

Special rules for tax-exempt bonds.--The bill would permit Indian tribal governments to issue tax-exempt industrial development bonds only where the primary activities of the businesses benefiting from the bonds take place on the reservation and where substantially all of the off-reservation activities are purchasing, marketing, and similar related activities. Additionally, interest on bonds other than IDBs would be exempt from tax only if substantially all of the proceeds of the obligations are used in the exercise of essential governmental functions or for a public utility.

Effective Date

In general, the bill would apply to taxable years beginning after 1979.

The provisions related to tax-exempt bonds would apply to obligations of Indian tribal governments issued after the date of enactment in taxable years ending after that date.

The provisions amending the estate or gift taxes would apply to estates of individuals dying or gifts made after 1979.

The excise tax provisions would be effective on January 1, 1980.

Revenue Effect

It is estimated that this bill would reduce budget receipts by less than \$10 million annually.



2. S. 2197--Senators Matsunaga, Roth,
Moynihan, and Durenberger

Modification and Expansion of Exemption for Certain
Taxicabs from Gasoline and Special Fuels Excise Taxes

Present Law

Under present law, gasoline and special fuels used in qualified taxicabs are not subject to the excise taxes imposed on those fuels under Code sections 4081 and 4041 respectively when used in furnishing qualified taxicab services (sec. 6427(e)). Qualified taxicab services means furnishing of nonscheduled land transportation for a fixed fare by a licensed operator who is not prohibited by law or company policy from furnishing shared transportation (with consent of the passengers). Taxicabs which are manufactured after 1978 must have a fuel economy rating in excess of the average EPA rating for the type of vehicle involved to qualify for this exemption.

The tax on gasoline is 4 cents per gallon and is imposed on the producer or importer of the gasoline. After September 30, 1984, that tax will be 1-1/2 cents per gallon. The tax on special fuels is also 4 cents per gallon, imposed on the retail sale of the fuels. That tax is also scheduled to decrease to 1-1/2 cents per gallon after September 30, 1984.

The exemption for qualified taxicab use is accomplished by means of a refund or credit against income tax claimed for the amount of tax originally paid on purchase of the fuels.

The present exemption is scheduled to expire on January 1, 1983.

Issues

The first issue is whether the exemption from fuels taxes for fuels used in providing qualified taxicab services should be allowed as an exemption when the fuel is purchased or as a credit or refund for tax paid based upon records showing that purchased fuel is actually used for an exempt purpose.

The second issue is whether this exemption should be made permanent.

The third issue is whether the exemption should be allowed where the taxicabs have a fuel economy rating of 75 percent of the average EPA rating.

Explanation of the Bill

Under the bill, exemption from the excise taxes on gasoline and special fuels used by qualified taxicabs providing qualified taxicab services would be provided to certain taxicab operators at the time the fuels are purchased, rather than by means of a refund or credit as is done under present law. To qualify for exemption at the time the fuels are purchased, taxicab operators would have to register with the Internal Revenue Service as an exempt user. The Service would be authorized to establish registration procedures under which operators would qualify as exempt purchasers. Tax paid on fuels used in providing qualified taxicab services where the taxicab operator was not registered would continue to be refunded or credited as under present law.

In addition, vehicles eligible for the taxicab exemption would be expanded to include vehicles with a fuel economy rating in excess of 75 percent of the average EPA rating for the type of vehicle involved.

Further, the bill would make this exemption from tax permanent.

Effective Date

The provisions of the bill would apply to sales of fuel after December 31, 1981.

Revenue Effect

It is estimated that this bill would reduce fiscal year budget receipts by \$5 million for 1983, \$8 million for 1984, \$9 million for 1985, \$10 million for 1986 and 1987. (These revenues would otherwise go into the Highway Trust Fund through September 30, 1984.)

3. S. 2498--Senators Matsunaga and Durenberger

Exception for Educational Organizations from Certain
Unrelated Business Income Provisions

Present Law

Under present law (Code sec. 511), generally, any qualified pension trust or organization that is otherwise exempt from Federal income tax is taxed on income from trades or businesses that are unrelated to the organization's exempt purposes; it is not taxed on passive investment income or income from any trade or business that is related to the organization's exempt purposes.

Specifically, present law (sec. 514(a)) provides that an exempt organization's income from "debt-financed property," which is not used for its exempt function, is to be subject to tax as unrelated business income in the proportion in which the property is financed by debt. Debt-financed property is defined as any property which is held to produce income and with respect to which there is acquisition indebtedness at any time during the taxable year or during the 12 months prior to disposition if the property is disposed of during the taxable year (sec. 514(b)). A debt constitutes acquisition indebtedness with respect to property if the debt was incurred in acquiring or improving the property, or if the debt would not have been incurred "but for" the acquisition or improvement of the property (sec. 514(c)).

With certain exceptions, indebtedness incurred by a qualified pension trust as a result of the acquisition or improvement of real property is not considered "acquisition indebtedness" (sec. 514(c)(9)). Thus, income or gain received from, or with respect to, such debt-financed real property is not treated as income from debt-financed property. However, the special exemption for debt-financed real property for qualified pension trusts does not apply in cases: (1) where the acquisition price is not a fixed amount determined as of the date of acquisition; (2) where the amount of the indebtedness, or the amount payable thereon, or the time for making any payments, is dependent (in whole or in part) or the future revenues derived from the property; (3) where the property is leased by the trust to the seller or a person related to the seller; (4) where the property is acquired by a qualified trust from a person related to the pension plan under which the trust is formed or if such property is leased to such a related person; and (5) where the seller, a person related to the seller, or a person related to the pension plan provides nonrecourse financing for the transaction, and the debt is subordinate to any other indebtedness on the property or the debt bears a less than arm's-length interest rate.



Income of a gratified trust generally is taxable to its beneficiaries upon distribution. Income of an exempt organization is never subject to tax at a later date.

Issue

The issue is whether the exception for qualified pension trusts from the definition of acquisition indebtedness should be expanded to include educational organizations.

Effective Date

The provisions of the bill would be effective for taxable years beginning after December 31, 1982.

Revenue Effect

It is estimated that at the outset this bill would reduce budget receipts by less than \$10 million annually. For later years, the revenue effect is indeterminate but could be substantial.

