DESCRIPTION OF H.R. 2972

(DRUG WAR BOND ACT OF 1989)

Scheduled for a Hearing

Before the

HOUSE COMMITTEE ON WAYS AND MEANS

on April 25, 1990

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

April 23, 1990

JCX-11-90

INTRODUCTION

The Committee on Ways and Means has scheduled a public hearing on April 25, 1990, on H.R. 2972 (Drug War Bond Act of 1989). H.R. 2972 was introduced on July 31, 1989, by Mr. Lewis (of California) and others. The bill was referred jointly to the Committees on Ways and Means, the Judiciary, Education and Labor, Government Operations, and Rules.

This document,[1] prepared by the staff of the Joint Committee on Taxation in connection with the hearing, provides a description of present-law provisions and of the bill.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of H.R. 2972 (Drug War Bond Act of 1989) (JCX-11-90), April 23, 1990.

PRESENT LAW

Interest generally subject to tax

Interest income, including interest earned on bonds, notes, or other certificates of indebtedness issued by the Federal Government, generally is subject to Federal income, estate, and gift taxes. However, interest on certain bonds issued by State and local governments is exempt from Federal taxation. In addition, taxation of interest accruals on U.S. Series EE Savings Bonds may be deferred by cash-basis taxpayers until transfer of ownership or redemption of the bonds.

Although subject to Federal taxation, interest earned on Federal Government obligations generally is exempt from all State and local taxation.

Series EE savings bonds

Generally, all U.S. Series EE savings bonds can be purchased through payroll savings plans, at most commercial banks, at many savings and loan associations, and at other qualified financial institutions. Such bonds can be purchased in various denominations, ranging from $50 to $10,000. The purchase price is one-half the denomination (or face value) of the bond. In any one year, a person may purchase Series EE savings bonds with denominations totalling $30,000. The interest rate on Series EE savings bonds varies, depending on how long the bonds are held. The interest rate on such bonds held for more than five years is based on the market rate for Treasury outstanding obligations with five years to maturity. Bonds held for less than five years earn interest on a fixed graduated scale. Interest earned on Series EE savings bonds is paid when the bonds are redeemed.

Receipts from the sale of Series EE savings bonds and other Federal Government obligations historically have been placed in the general fund of the U.S. Treasury.

Educational savings bonds

Under a special Internal Revenue Code provision enacted as part of the Technical and Miscellaneous Revenue Act of 1988, interest income earned on a qualified U.S. Series EE savings bond issued after December 31, 1989, is excludable from gross income if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during the taxable year (sec. 135).

The exclusion from gross income of interest on U.S.

Series EE savings bonds is available only to taxpayers who are issued such bonds after having attained age 24. During the year the bond is redeemed, the taxpayer to whom such bond was issued must pay qualified higher education expenses, meaning tuition and required fees for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at an eligible educational institution.

The exclusion is phased out for certain upper-income taxpayers. A taxpayer's AGI (i.e., adjusted gross income) for the year during which the bond is redeemed determines whether or not the phaseout applies. For taxpayers filing a joint return, the phaseout range is for AGI between $60,000 and $90,000. For single taxpayers and heads of households, the phaseout range is for AGI between $40,000 and $55,000. The phaseout rate for the exclusion is applied ratably over the income phaseout range.

Designation of tax to Presidential Election Campaign Fund

Individual taxpayers may designate that $1 of the taxpayer's income tax liability ($2 for taxpayer's filing joint returns) be paid over to the Presidential Election Campaign Fund (sec. 6096). Payments are made from this Fund to eligible candidates for President and Vice President of the United States to defray qualified campaign expenses (secs. 9001-9006).

Contributions to the United States and Federal agencies

Taxpayers who itemize deductions are allowed to claim a deduction (subject to certain limitations) for Federal income tax purposes for charitable contributions, including contributions or gifts to the United States made for exclusively public purposes (sec. 170(c)(1)). The Treasury Department has joint authority with the General Services Administration to accept gifts for the purpose of reducing the national debt (31 U.S.C. 3113) and for defense purposes (50 U.S.C. 1151). In addition, numerous statutes authorize various Federal agencies (e.g., the Departments of Treasury, Commerce, Transportation, Housing and Urban Development, Agriculture, and State) to accept gifts for assisting in the conduct of agency activities.

The Comptroller General has ruled that agencies may not accept gifts and bequests for assisting them in carrying out governmental functions in the absence of specific statutory authorization (36 Comp. Gen. 268).

Prior law treatment of interest on U.S. bonds

Before February 19, 1941, interest earned on U.S. debt was exempt from all taxation (except estate and inheritance taxes) with respect to principal, interest, and discount at time of issue. Gain from the sale or other disposition of Treasury bills also was exempt from all taxation. The exemption applied to taxation by the United States, any State, or any U.S. possession, or any local taxing authority.

The exemption was repealed by the Public Debt Act of 1941 (55 Stat. 9) with respect to taxation by the United States or any agency or instrumentality of the U.S. The exemption was not repealed with respect to taxation of such interest by the District of Columbia, or by such Federal entities as a Territory, a Possession of the U.S., or any of their political subdivisions. The exemption from taxation by a State was not changed by this Act.

DESCRIPTION OF THE BILL

The bill would be cited as the "Drug War Bond Act of 1989." Its policy statement with respect to expenditures indicates that expenditures authorized from the War on Drugs Trust Fund that would be established by this bill for existing Federal anti-drug activities are to be in addition to current levels of appropriations for such activities.

Drug War Bonds

The Secretary of the Treasury would be authorized to issue up to $4 billion of Drug War Bonds, and the proceeds from their sale would be deposited into the War on Drugs Trust Fund.

Interest received by individuals on Drug War Bonds would not be included in gross income of a taxable year for Federal income tax purposes.

Drug War Bonds could be issued with maturities of 12 years or less, with a minimum investment yield of 4 percent per year. Stamps could be issued in lesser amounts than the purchase price of the smallest bond denomination sold and would be exchangeable for bonds at the election of the individual holder. The Secretary also would be authorized to solicit private contributions to offset the administrative costs of issuing Drug War Stamps. The Secretary would recognize the patriotic participation of purchasers of Drug War Bonds with an appropriate item, e.g., bumper stickers, or window decals.

Bond issuing authority generally available to the Secretary under Title 31 of the United States Code would be employed by the Secretary in the issuance of Drug War Bonds. This authority includes determination of the investment yield on bonds issued. Yields on Series EE bonds are related to the market yield on outstanding Treasury issues of 5 year notes.

New War on Drugs Trust Fund

A proposed War on Drugs Trust Fund would be established in the Internal Revenue Code. Proceeds from the sale of Drug War Bonds and Stamps would be appropriated to the Trust Fund. In addition, taxpayers would be authorized to contribute to the Trust Fund $1 or more from any tax overpayment (treated as a refund first, for administrative purposes) and any desired cash contribution that would accompany a tax return. Such contributions to the Trust Fund would be designated by taxpayers on the first page of their income tax return. In addition, contributions from the Department of Justice Assets Forfeiture Fund could be made to the Trust Fund.

Amounts in the Trust Fund would be available to the Secretary to meet the costs of administering the Drug War Bond program, and for paying administrative costs relating to taxpayer contributions of cash and tax refunds to the Trust Fund.

In addition, funds would be provided to the President, after consultation with the Director of National Drug Control Policy, for the following purposes:

(1) constructing Federal prisons which also could house State prisoners, charging a State an appropriate per diem rate per prisoner;

(2) carrying out recommendations of the National Advisory Commission on Law Enforcement with respect to salaries and expenses of U.S. Attorneys Offices, the Drug Enforcement Administration, the U.S. Marshals Service, the FBI, the Bureau of Alcohol, Tobacco and Firearms, and the U.S. Customs Service;

(3) supplemental funds to the Justice Assistance Block Grant Program to enhance State and local drug enforcement activities;

(4) the President's Media Commission on Alcohol and Drug Abuse Prevention;

(5) education and rehabilitation programs; and

(6) demonstration programs for drug abuse prevention and rehabilitation, improvement of local government facilities to incarcerate drug offenders, a college credit and job training program for disadvantaged youth in an in-residency work/study center, televised drug counseling programs and interactive group support meetings, and a program which addresses violent drug gang activities.

<u>Budgetary Treatment of Trust Fund</u>

The receipts and disbursements (including administrative expenses related to the Trust Fund) of the War on Drugs Trust Fund would not be included in budget totals of the President's budget submission or the congressional budget and its allocations. The Trust Fund amounts also would be exempt from any general statutory limitation on budget outlays and from any sequestration or other budget outlay reduction under the Gramm-Rudman-Hollings Act, i.e., the Balanced Budget and Emergency Deficit Control Act of 1985

<u>Reports to Congress</u>

Within 3 years after the date of enactment, the Secretary of the Treasury would be required to report to

Congress findings and recommendations concerning the programs established under the bill.

One year after the date of enactment, the Attorney General would be required to report to Congress recommendations on the merits of privatizing Federal prisons.

Effective Date

Under H.R. 2972 as introduced, authority for taxpayers to designate portions of tax refund and to make cash contributions would have been effective for taxable years beginning after December 31, 1989, and the budgetary treatment of the War on Drugs Trust Fund would have become effective for fiscal years beginning after September 30, 1989.