DESCRIPTION OF H.R. 831

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of H.R. 831, introduced on February 6, 1995, by Chairman Archer and co-sponsored by Mr. Matsui, Mr. Thomas and Mrs. Johnson. The bill would (1) extend permanently the 25-percent deduction for health insurance costs of self-employed individuals; (2) repeal the provision permitting nonrecognition of gain on sales and exchanges effectuating policies of the Federal Communications Commission and prohibit nonrecognition of gain on involuntary conversions in certain related-party transactions; and (3) deny the earned income tax credit to individuals having more than $2,500 of interest and dividend income.

The House Committee on Ways and Means has scheduled a markup of H.R. 831 on February 8, 1995.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 831* (JCX-6-95), February 8, 1995.

I. PERMANENTLY EXTEND DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS

Present Law

Under present law, the tax treatment of health insurance expenses depends on whether the taxpayer is an employee and whether the taxpayer is covered under a health plan paid for by the employee's employer. An employer's contribution to a plan providing accident or health coverage for the employee and the employee's spouse and dependents is excludable from an employee's income. The exclusion is generally available in the case of owners of a business who are also employees.

In the case of self-employed individuals (i.e., sole proprietors or partners in a partnership) no equivalent exclusion applies. However, prior law provided a deduction for 25 percent of the amount paid for health insurance for a self-employed individual and the individual's spouse and dependents. The 25-percent deduction was not available for any month if the taxpayer was eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. In addition, no deduction was available to the extent that the deduction exceeded the taxpayer's earned income. The amount of expenses paid for health insurance in excess of the deductible amount could be taken into account in determining whether the individual was entitled to an itemized deduction for medical expenses. The 25-percent deduction expired for taxable years beginning after December 31, 1993.

For purposes of these rules, more than 2-percent shareholders of S corporations are treated the same as self-employed individuals. Thus, they were entitled to the 25-percent deduction.

Other individuals who purchase their own health insurance (e.g., someone whose employer does not provide health insurance) can deduct their insurance premiums only to the extent that the premiums, when combined with other unreimbursed medical expenses, exceed 7.5 percent of adjusted gross income.

Description of Bill

The bill would retroactively reinstate for 1994 the deduction for 25-percent of health insurance costs of self-employed individuals and would extend the deduction permanently.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1993.

II. REPEAL SPECIAL RULES APPLICABLE TO FCC-CERTIFIED SALES OF BROADCAST PROPERTIES; PROHIBIT NONRECOGNITION OF GAIN ON INVOLUNTARY CONVERSIONS IN CERTAIN RELATED-PARTY TRANSACTIONS

Present Law and Background

Tax treatment of a seller of broadcast property

General tax rules

Under generally applicable Code provisions, the seller of a business, including a broadcast business, recognizes gain to the extent the sale price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is then subject to the income tax.

Special rules under Code section 1033

Under Code section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property. Only involuntary conversions that result from destruction, theft, seizure, or condemnation (or threat or imminence thereof) is eligible for deferral under this provision. Thus, for example, an order by a federal court to a corporation to divest itself of ownership of certain stock because of anti-trust rules, is not a condemnation (or a threat or imminence thereof), and not eligible for deferral under this provision, according to a ruling by the Internal Revenue Service (the "IRS").

In addition, under rulings issued by the IRS to taxpayers, property (stock or assets) purchased from a related person may, in some cases, qualify as property similar or related in service or use to the converted property. Satisfaction of the replacement property requirement through a purchase from a related party may effectively result in a total tax forgiveness for the transaction.

Special rules under Code section 1071

Under Code section 1071, if the Federal Communications Commission ("FCC") certifies that a sale or exchange of property is necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the FCC with respect to the ownership and control of "radio broadcasting stations," a taxpayer may elect to treat the sale or exchange as an involuntary conversion. The FCC is not required to determine the tax consequences of certifying a sale or to consult with the IRS about the certification process.[2]

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[2] The FCC allows sellers applying for FCC certificates in cable transactions to delete both the sales price and the number of subscribers from the transaction documents submitted with the

The term "radio broadcasting stations" has been interpreted to include radio stations, television stations and cable television.

Under Code section 1071, the replacement requirement in the case of FCC-certified sales may be satisfied by purchasing stock of a corporation that owns broadcasting property, whether or not the stock represents control of the corporation. In addition, even if the taxpayer does not reinvest all the sales proceeds in similar or related replacement property, the taxpayer nonetheless may elect to defer recognition of gain if the basis of depreciable property that is owned by the taxpayer immediately after the sale or that is acquired during the same taxable year is reduced by the amount of deferred gain.

There is no limit on the amount of gain that may be deferred under Code section 1071.

Tax treatment of a buyer of broadcast property

Under generally applicable Code provisions, the purchaser of a broadcast business, or any other business, acquires a basis equal to the purchase price paid. In an asset acquisition, a buyer must allocate the purchase price among the purchased assets to determine the buyer's basis in these assets. In a stock acquisition, the buyer takes a basis in the stock equal to the purchase price paid, and the business retains its basis in the assets. This treatment applies whether or not the seller of the broadcast property has received an FCC certificate exempting the sale transaction from the normal tax treatment.

FCC tax certificate programs

Multiple ownership policy

In 1943, the FCC adopted a rule that prohibited duopolies (ownership of more than one station in the same city). After these rules were adopted, owners wishing to acquire additional stations in excess of the national ownership limit had to divest themselves of stations they already owned in order to remain in compliance with the FCC's rules. After the special tax rules for FCC-certified sales were adopted in 1943, in some cases parties petitioned the FCC for tax certificates when divesting themselves of stations.

Minority ownership policy

In 1978, the FCC announced a policy of promoting minority ownership of broadcast facilities by offering an FCC tax certificate to those who voluntarily sell such facilities (either in the form of assets or stock) to minority-owned or minority-controlled entities.

"Minorities" within the meaning of the FCC's policy include "Blacks, Hispanics, American

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request for the certificates.

Indians, Alaska Natives, Asians, and Pacific Islanders." As a general rule, a minority-controlled corporation is one in which more than 50 percent of the voting stock is held by minorities. A minority-controlled limited partnership is one in which the general partner is a minority or minority-controlled, and minorities have at least a 20-percent interest in the partnership. The FCC requires those who acquire broadcast properties with the help of the FCC tax certificate policy to hold those properties for at least one year. An acquisition can qualify even if there is a pre-existing agreement (or option) to buy out the minority interests at the end of the one-year holding period.

In 1982, the FCC further expanded its tax certificate policy for minority ownership. At that time, the FCC decided that, in addition to those who sell properties to minority-owned or minority-controlled entities, investors who contribute to the stabilization of the capital base of a minority enterprise would be entitled to a tax certificate upon the subsequent sale of their interest in the minority entity.

Personal communications services ownership policy

In 1993, Congress provided for the orderly transfer of frequencies, including frequencies that can be licensed pursuant to competitive bidding procedures. The FCC has adopted rules to conduct auctions for the award of more than 2,000 licenses to provide personal communications services ("PCS").[3]

In their proposed rules, the FCC has designed procedures to ensure that women and minorities (as well as rural telephone companies and small businesses) have the opportunity to participate in the provision of PCS. In addition to non-tax steps to encourage the participation of women and minorities, the FCC will extend the tax certificate program in three ways: (1) initial investors in minority and woman-owned PCS businesses will be eligible for FCC tax certificates upon the sale of their investments; (2) holders of PCS licenses will be able to obtain FCC tax certificates upon the sale of the business to a company controlled by minorities and women; and (3) a cellular operator that sells its interest in an overlapping cellular system to a minority or a woman-owned business to come into compliance with the FCC PCS/cellular cross-ownership rule will be eligible for a tax certificate.[4]

[3] PCS will be provided by means of a new generation of communication devices that will include small, lightweight, multi-function portable phones, portable facsimile and other imaging devices, new types of multi-channel cordless phones, and advanced paging devices with two-way data capabilities.

[4] Tax certificates also have been employed as a means of encouraging fixed microwave operators to relocate from spectrum allocated to emerging technologies. An AM expanded band policy also is available, but has never been used.

Congressional appropriations rider

Since 1987, the FCC has been subject to a Congressional appropriations rider that prohibits the FCC from using any appropriated funds to repeal, to retroactively apply changes in, or to continue a reexamination of its minority ownership programs relating to broadcasting licenses. The rider will expire at the end of the 1995 fiscal year, September 30, 1995.

Description of Bill

The bill would repeal Code section 1071, the special election to treat FCC-certified sales as involuntary conversions. Thus, a sale or exchange of broadcast properties would be taxable unless otherwise tax-deferred under another provision of present law (e.g., as a like-kind exchange).

In addition, the bill would not permit a taxpayer to treat the purchase of property (either stock or assets) from a related person as replacement property for purposes of Code section 1033.

Effective Date

The repeal of Code section 1071 would be effective for sales or exchanges completed, or certificates issued by the FCC, on or after January 17, 1995. The bill would not apply to taxpayers who have entered into a binding written contract before January 17, 1995 and applied for an FCC tax certificate by that date. A contract that is contingent on receipt of an FCC tax certificate would not be a binding contract.

The prohibition against nonrecognition of gain in certain related-party transactions would apply to replacement property or stock acquired on or after February 6, 1995.

III. INTEREST AND DIVIDEND TEST FOR EARNED INCOME TAX CREDIT

Present Law

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit an eligible taxpayer may claim depends upon whether the taxpayer has one, more than one, or no qualifying children and is determined by multiplying the credit rate by the taxpayer's earned income up to an earned income threshold. The maximum amount of the credit is the product of the credit rate and the earned income threshold. For taxpayers with earned income (or adjusted gross income, if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or adjusted gross income, if greater) in excess of the phaseout threshold. The credit is not allowed if earned income (or adjusted gross income, if greater) exceeds the phaseout limit. There is no additional limitation on the amount of interest and dividend income that the taxpayer may receive.

The parameters for the EITC depend upon the number of qualifying children the taxpayer claims. For 1995, the parameters are as follows:

	Two or more qualifying children--	One qualifying child--	No qualifying children--
Credit rate	36.00%	34.00%	7.65%
Phaseout rate	20.22%	15.98%	7.65%
Earned income threshold	$8,640	$6,160	$4,100
Maximum credit	$3,110	$2,094	$314
Phaseout threshold	$11,290	$11,290	$5,130
Phaseout limit	$26,673	$24,396	$9,230

The earned income threshold and the phaseout threshold are indexed for inflation; because the phaseout limit depends on those amounts, the phaseout rate, and the credit rate, the phaseout limit will also increase if there is inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates and phaseout rates for the EITC change over time under present law. For 1996 and after, the credit rate will be 40.00 percent and the phaseout rate will be 21.06 percent for taxpayers with two or more qualifying children. The credit rate and the phaseout rate for taxpayers with one qualifying child or no qualifying children will be the same as those listed in the

table above.

To claim the EITC, a taxpayer must either have a qualifying child or must meet other requirements. A qualifying child must meet a relationship test, an age test, and a residence test. To claim the EITC without a qualifying child, a taxpayer must not be a dependent and must be over age 24 and under age 65.

Description of Bill

Under the bill, a taxpayer would not be eligible for the EITC if the aggregate interest and dividend income includible in his income for the taxable year exceeds $2,500. For taxable years beginning after 1996, the $2,500 limit would be indexed for inflation with rounding to the nearest multiple of $10.

Effective Date

The bill would be effective for taxable years beginning after December 31, 1995.