[JOINT COMMITTEE PRINT]

DESCRIPTION OF MISCELLANEOUS TAX BILLS

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON APRIL 17, 1980

PREPARED FOR THE USE OF THE

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INTRODUCTION

This pamphlet provides a description of seven miscellaneous tax bills scheduled for a public hearing on April 17, 1980, by the Ways and Means Subcommittee on Select Revenue Measures. The first part is a summary of the bills. This is followed by a more detailed description of the seven bills (in numerical order), including a description of present law, issues involved, an explanation of the provisions of the bills, effective dates, and estimated revenue effects.

A separate pamphlet describes H.R. 6883, the Installment Sales Revision Act of 1980, which is also scheduled for the hearing on April 17, 1980.

I. SUMMARY

1. H.R. 5616—Messrs. Coelho, Corman and Others

Excise Tax Treatment for Wine Used in Distilled Spirits Products

Prior to January 1, 1980 (the effective date of the distilled spirits tax provisions of P.L. 96–39, the Trade Agreements Act of 1979), wine was generally subject to the applicable wine excise tax when it was withdrawn from the bonded wine cellar where it was produced. Where wine was used in the production of a distilled spirits product, the wine was taxed at the lower wine excise tax rate prior to blending with the distilled spirits. The distilled spirits component of a product was similarly taxed prior to blending at the distilled spirits tax rate ($10.50 per proof gallon). Also, a 30-cent per proof gallon rectification tax was imposed on the blended product.

The 1979 Act modified the excise tax treatment of distilled spirits products so that the final distilled spirit product (including wine and alcoholic flavorings) is taxed on the alcohol (proof) content of the final product at the $10.50 per proof gallon distilled spirits tax rate. This method is known as the "all-in-bond" system.

The bill would provide a credit against the excise tax liability under the all-in-bond method for the difference between the distilled spirits tax ($10.50 per proof gallon) and the applicable wine excise tax on the wine used in the distilled spirits product as if the wine had been subject to the wine tax (as generally imposed under Code sec. 5041 but for its removal to bonded premises). The credit would be available for domestically produced products and imported distilled spirits products containing wine, and would be effective on January 1 ,1980.

2. H.R. 5729—Mr. Conable

Amortization of Business Startup Costs

Under present law, costs incurred prior to the commencement of a business normally are nondeductible expenses because they are not incurred in carrying on a trade or business. These startup or preopening costs must be capitalized and often cannot be depreciated or amortized because no ascertainable useful life can be established for these costs. However, the capitalized costs may be recovered for purposes of measuring gain or loss upon the disposition or cessation of the business.

The bill would allow an elective 60-month amortization period for certain ordinary and necessary business startup costs which are incurred incident to the investigation, formation, or creation of a trade or business entered into by the taxpayer.

3. H.R. 6039—Mr. Lederer

Tax Treatment of Annuities Purchased for Employees of the Uniformed Services University of the Health Sciences

Present law provides that, if an annuity is purchased for an employee by an exempt organization described in Code section 501(c)(3) or by a public school system, the employer's contributions for the annuity contract are excludable, within certain limitations, from the employee's gross income and not subject to tax until the employee receives payments under the annuity contract.

The bill would extend the same rule to qualifying annuities purchased for the civilian staff and faculty of the Uniformed Services University of the Health Sciences, which was established by the Congress under the Department of Defense to train medical students for the uniformed services.

4. H.R. 6140—Messrs. Ullman, Rostenkowski and Conable

Qualified Pension Plan Requirements for Professional Organizations Involving Multiple Corporations or Other Entities

Under present law, individuals employed by certain separate but related entities are aggregated and treated as employed by a single employer for purposes of the rules relating to qualified retirement plans. To eliminate certain abuses resulting under present law, the bill would expand the aggregation rules with respect to the treatment of certain professional organizations for purposes of satisfying requirements for qualified retirement plans.

5. H.R. 6247—Mr. Gibbons

Treatment of Certain Community Income for Spouses Living Apart

Under present law, income considered community property under State law is taxed in equal shares to a husband and wife. Generally, under the bill, community property laws would be disregarded for income tax purposes when the spouses have lived apart for the entire year and no portion of the income earned by one spouse has been transferred to the other spouse. The bill is intended to provide relief for abandoned spouses who are presently taxed on a portion of the income earned by the other spouse.

6. H.R. 6824—Mr. Cotter

Nonqualified Deferred Compensation Arrangements Maintained by Tax-Exempt Organizations

Under the bill, the taxable year of inclusion in gross income by an employee of any amount covered by a nonqualified deferred compensation plan maintained by a tax-exempt organization would be determined in accordance with the principles set forth in regulations, rulings, and judicial decisions in effect on February 1, 1978, and without regard to Treasury regulations proposed on February 3, 1978.

7. H.R. 7009—Messrs. Rostenkowski, Stark, Lederer, Fowler, Duncan (Tenn.), and Vander Jagt

Income Tax Exclusion for Certain Federal Scholarship Grants

Under present law, amounts received as scholarships or fellowship grants at educational institutions generally are excluded from gross income unless, as a condition to receiving such amounts, the recipient must agree to perform services for the grantor. Temporary legislation provides an exclusion for amounts received by members of a uniformed service entering the Armed Forces Health Professions Scholarship Program and similar programs before January 1, 1981.

In general, the bill would exempt from taxation scholarships received under Federal programs which require future Federal service by the recipients to the extent that the scholarships are used for tuition, fees, and related expenses.

II. DESCRIPTION OF BILLS

1. H.R. 5616—Messrs. Coelho and Corman and Others

Excise Tax Treatment for Wine Used in Distilled Spirits Products

Present law

Excise tax rates on wine

The excise tax on wine depends on the alcohol content (by volume) and whether the wine is carbonated or non-carbonated (still wine). Still wines are taxed as follows: (a) 17 cents per wine gallon for wines containing not more than 14 percent alcohol; (b) 67 cents per wine gallon for wines containing more than 14 percent and not more than 21 percent alcohol; and (c) $2.25 per wine gallon for wines containing more than 21 percent and not more than 24 percent alcohol. Champagne and other sparkling wines are taxed at $3.40 per wine gallon and artificially carbonated wines are taxed at $2.40 per wine gallon. (All wines containing more than 24 percent alcohol by volume are classed and taxed as distilled spirits—at $10.50 per proof gallon.)

Method of taxing wine used in distilled spirits products

One use for wine is to combine it with distilled spirits to produce distilled spirits products, such as blended whiskeys, cordials and liquers. Under law in effect prior to January 1, 1980, wine used to produce distilled spirits products was subject to the applicable wine tax when this wine was withdrawn from the bonded wine cellar where it was produced. The distilled spirits tax of $10.50 per proof gallon was correspondingly imposed on the distilled spirits before the wine and distilled spirits components were blended to produce the distilled spirits product. In addition, a 30-cent-per-proof gallon rectification tax was generally imposed on the blended product. Prior law also included provisions under which alcoholic flavorings used to produce distilled spirits products were subject to an effective rate tax of $1.00 per proof gallon before they were blended into a distilled spirit product.

The Trade Agreements Act of 1979 (P.L. 96–39, approved July 26, 1979) generally implements the trade agreements reached under the multilateral trade negotiations. A part of this legislation equalizes the U.S. excise tax treatment of U.S. and foreign-produced distilled spirits and modernizes the system for imposing and administering the distilled spirits tax. This new system is referred to as the "all-in-bond" method and was generally effective on January 1, 1980. Under the all-in-bond method wine used to produce distilled spirits products is not subject to the wine tax. Instead, this wine is transferred in bond (before any tax is determined) to the distilled spirits plant where it becomes part of a distilled spirits product. The distilled spirits tax is then imposed on the completed product, including the wine component.

(The 30-cent rectification tax was also repealed under the all-in-bond changes.)

A result of the change to the all-in-bond method is that alcohol in wine which is included in a distilled spirits product is subject to the $10.50 per proof gallon distilled spirits tax, rather than the generally lower total of the applicable wine tax and the prior rectification tax.[1] The distilled spirits tax is also similarly imposed on any alcoholic flavorings which are part of the blended product.

Issues

The main issue is whether wine used in distilled spirits products should be taxed on its alcohol (proof) content as under the all-in-bond method or as it was prior to the Trade Agreements Act of 1979. If a credit were allowed, another issue would be the timing of the credit for domestically produced and imported spirits containing wine. In addition there is an issue as to whether alcoholic flavoring used in distilled spirits products should be accorded the lower effective rates of tax which existed under prior law.

Explanation of the bill

The bill would provide a credit against excise tax liability under the all-in-bond method for the difference between the distilled spirits tax ($10.50 per proof gallon) and the applicable wine tax on this wine if the wine had been subject to the wine tax (as imposed under Code sec. 5041 but for its removal to bonded premises). The credit would be available only on wine which becomes part of a distilled spirits product and would be determined, in the case of domestically produced distilled spirits products, when the wine is dumped for processing and would be allowed for the return period in which the wine is so dumped. This credit would also be available for wine included in distilled spirits products which are produced abroad and imported into the United States and would be determined and allowed at the time the distilled spirits tax is imposed.

The wine content of imported distilled spirits would be established by such chemical analysis, certification, or other method as may be set forth in regulations.

Effective date

The provisions of the bill would be effective on January 1, 1980, the same date when the all-in-bond method became effective under the Trade Agreements Act of 1979.

Revenue effect

It is estimated that the bill would reduce budget receipts by at least $5 million annually from the amount that would be collected under the all-in-bond method.

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[1] Although P.L. 96–39 was effective on January 1, 1980, the Bureau of Alcohol, Tobacco, and Firearms (ATF) of the Treasury Department issued a temporary rule (45 *Fed. Reg.* 7528, Feb. 1, 1980; Treas. Dec. ATF–64) deferring the payment of the distilled spirits tax attributable to the wine component of distilled spirits products. This deferral applied only to the first three semi-monthly return periods for spirits withdrawn during 1980, but the tax so deferred was due and payable on March 20, 1980; no further extension has been granted.

Other Congressional action

The Senate Finance Subcommittee on Taxation and Debt Management Generally held a hearing on an identical bill (S. 1913, introduced by Senators Cranston and Hayakawa) on December 19, 1979. On March 4, 1980, the Senate approved a similar amendment (by Sen. Cranston) to H.R. 4612 (relating to Social Security benefits for disabled children). For domestically produced spirits, the Senate amendment to H.R. 4612 would determine the credit at the time the tax is determined on the distilled spirits containing such wine and would allow the credit for the return period in which the distilled spirits tax is payable. For imported spirits, the amendment would be determined and allowed when the distilled spirits tax is imposed (as in H.R. 5616). H.R. 4612 is awaiting a House-Senate conference.

2. H.R. 5729—Mr. Conable

Amortization of Business Startup Costs

Present law

In general

Under present law, ordinary and necessary expenses paid or incurred in carrying on a trade or business, or engaging in a profit-seeking activity, are deductible. Expenses incurred prior to the establishment of a business normally are not currently deductible since they are not incurred in carrying on a trade or business or while engaging in a profit-seeking activity.

Expenses or costs incurred in acquiring or creating an asset, *e.g.*, a business, which has a useful life that extends beyond the taxable year normally must be capitalized. These costs ordinarily may be recovered through depreciation or amortization deductions over the useful life of the asset. However, costs which relate to an asset with either an unlimited or indeterminate useful life may be recovered only upon a disposition or cessation of the business.

Certain business organizational expenses incurred in the formation of a corporation or partnership may be treated as deferred expenses, on an elective basis, and amortized over a period of not less than 60 months (secs. 248 and 709). Expenditures eligible for amortization include only those expenditures which are directly incident to the creation of the corporation or business. Pre-opening or startup expenses, such as employee training expenses, are ineligible for amortization under this provision.

Investigatory expenses

Business investigatory expenses may be of either a general or specific nature. The former are related either to businesses generally, or to a category of business; the latter are related to a particular business. All investigatory expenses are costs incurred in seeking and reviewing prospective businesses prior to reaching a decision to acquire or enter any business.

Business investigatory expenses generally are nondeductible regardless of the status of the taxpayer by whom they may be incurred. However, taxpayers may be able to deduct a loss for business investigatory expenses incurred in an unsuccessful attempt to acquire a specific business.[1] Nevertheless, business investigatory expenses of a general nature normally are viewed as being either nondeductible personal expenses, or as not being ordinary and necessary trade or business expenses, viz., because no business exists, within the meaning of section 162 of the Code.

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[1] See *Harris W. Seed*, 52 T.C. 880 (1969), *acq.*, 1970–2 C.B. xxi; Rev. Rul. 77–254, 1977 2 C.B. 63.

Startup costs

Startup or preopening expenses are those costs which are incurred subsequent to a decision to acquire or establish a particular business, and prior to its actual operation. Generally the term "startup costs" refers to expenses which would be deductible currently if they were incurred after the commencement of the particular business operation to which they relate. Such costs may be incurred by a party who is not engaged in any existing business, or by a party with an existing business who begins a new one that is unrelated, or only tangentially related, to his or her existing business.

Start up costs may include expenses relating to advertising, employee training, lining-up distributors, suppliers, or potential customers, and professional services in setting up books and records. However, startup expenses also may refer to certain items which are nondeductible and nonamortizable even if they are incurred prior or subsequent to commencement of business operations. These nondeductible and nonamortizable expenses either may be of a purely capital nature, or may be capitalizable simply because they relate to a business with an indeterminate life.

Issues

Several issues are raised by the bill.

The first issue is whether any startup expenses paid or incurred by a taxpayer prior to the active operation of a particular trade or business should be deductible currently, or be deductible as a deferred expense over a period of not less than 60 months after the commencement of the trade or business as a going concern.

The next issue is whether all startup expenses (including any paid or incurred by an existing business incident to its commencement of an unrelated, or tangentially related, business) which may be amortized over a 60-month period should be required to be deducted over such a period, or whether those expenses should be amortizable at the election of the taxpayer.

The next issue is when any amortization election should be made.

Explanation of the bill

The bill would allow taxpayers an election to amortize, over a period of not less than 60 months, ordinary and necessary startup costs incurred incident to the investigation, formation, and creation of a trade or business entered into by the taxpayers.[2] The amortization election would apply only to ordinary and necessary startup costs which do not create an asset which has a useful life of its own and which are of a character which would allow the taxpayer to amortize them if they were expended incident to the investigation, formation, and creation of a trade or business having a determinable useful life. The election would apply only with respect to expenditures incurred with regard

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[2] The Subcommittee on Taxation and Debt Management generally of the Senate Committee on Finance held hearings on various tax bills on October 26, 1979. These bills included S. 1638, introduced by Senator Roth, which is identical to H.R. 5729. The Finance Committee has not acted on S. 1638.

The Federal Taxation Division of the American Institute of Certified Public Accountants has proposed allowing current deductions for startup costs and business investigatory expenses. AICPA, *Recommended Tax Laws Changes* 4–5, 6–7 (1980).

to a business actually entered into by the taxpayer, and would not apply if the business had an ascertainable useful life of less than 60 months. If the business is liquidated prior to the end of the 60-month period, any "startup" expenses which had not been amortized could be deducted to the extent allowed under present law.

The election would have to be made at the time, and in the manner, specified in Treasury regulations.

Effective date

The provisions of the bill would apply to amounts paid or incurred after December 31, 1979.

Revenue effect

Due to the lack of adequate information on the number of potential businesses formed and on the amount of expenses incurred in the process covered by the bill, no revenue estimate is available at this time.

3. H.R. 6039—Mr. Lederer

Tax Treatment of Annuities Purchased for Employees of the Uniformed Services University of the Health Sciences

Present law

If an annuity is purchased for an employee by an exempt organization described in Code section 501(c)(3) or by a public school system, the employer's contributions for the annuity contract are, within certain limitations, excludable from the employee's gross income and not subject to tax until the employee receives payments under the annuity contract (sec. 403(b)). Subject also to limitations generally applicable to tax-qualified retirement plans, the amount excludable in any year cannot exceed 20 percent of the employee's current annual compensation times the number of years of service, less amounts contributed tax-free in prior years.

In P.L. 92–426, Congress authorized establishment (under the Department of Defense) of the Uniformed Services University of the Health Sciences in order to train medical students for the uniformed services. This legislation authorizes hiring civilian faculty and staff members at salary schedules and with retirement benefits similar to those given to the faculty and staff of medical schools in the Washington, D.C. area. On July 15, 1975, the Secretary of Defense approved a tax-deferred annuity program for the faculty, similar to annuities available at certain medical schools in the Washington area and throughout the United States. However, because the University is a Federal instrumentality and is not an exempt organization described in section 501(c)(3), the annuities do not qualify under present law for tax deferral pursuant to section 403(b).

Issue

The issue is whether annuities purchased for the civilian faculty and staff of the Uniformed Services University of the Health Sciences should qualify for income tax deferral in the same manner as annuities purchased for employees of exempt organizations described in section 501(c)(3) or of public school systems.

Explanation of the bill

The bill would treat otherwise qualified annuities purchased for the civilian staff and faculty of the Uniformed Services University of the Health Sciences in the same manner for income tax purposes (sec. 403(b)) as employee annuities purchased by section 501(c)(3) organizations or by public school systems. Any qualified annuity purchased by the University would be subject to the same limitations as other annuities described in section 403(b).

Effective date

The provisions of the bill would apply to annuities purchased for service performed after December 31, 1979, in taxable years ending after that date.

Revenue effect

It is estimated that the bill would decrease budget receipts by less than $1 million per year.

Prior Congressional action

In the 95th Congress, an identical bill (H.R. 12606) passed the House, but was not acted upon by the Senate Finance Committee or considered by the Senate.

4. H.R. 6140—Messrs. Ullman, Rostenkowski, and Conable

Qualified Pension Plan Requirements for Professional Organizations Involving Multiple Corporations or Other Entities

Present law

Under present law, for purposes of testing the qualification of a pension, etc., plan, all employees of a controlled group of corporations and all employees of commonly controlled trades of businesses, whether or not incorporated, are treated as employed by a single employer. For purposes of this rule, a controlled group of corporations is determined generally by reference to the section 1563(a) definitions of parent-subsidiary controlled group and brother-sister controlled group. The commonly controlled trade or business determination is to be made under regulations which are to "be based on principles similar to the principles" which apply in the case of controlled groups of corporations.

However, corporations in a brother-sister relationship are aggregated for plan purposes only if the same five or fewer persons who are individuals, estates or trusts own, among other things, *more* than 50 percent of the voting power (or value) of the stock in two or more corporations, and other conditions are satisfied. Similar rules apply in the unincorporated trade or business regulations.

These rules allow individuals to avoid covering rank-and-file employees by establishing individual corporations which then form a partnership of corporations. The partnership employs the rank-and-file employees. Because neither corporation has a *more* than fifty percent interest in the partnership, the partnership is not a member of a group of commonly controlled trades or business. Therefore, the requirement of aggregation of employees for purposes of meeting the qualified plan rules does not apply. Since the aggregation rules do not apply, the plans established by the professional corporations need not provide coverage for the partnership employees.

This result has been affirmed by the Tax Court in a recent case, *Lloyd M. Garland, M.D., F.A.C.S., P.A.*, 73 T.C. ——, No. 1, (1979).

Issue

The issue is whether special anti-abuse rules should be provided with respect to the treatment of certain professional organizations for purposes of the requirements for qualified pension, etc., plans.

Explanation of the bill

The bill would expand the classes of controlled groups of businesses required to be considered as a single business in testing whether a pension, etc., plan maintained by any business in the group meets the tax-qualification requirements of the Code. In particular, the bill would require aggregation for pension, etc., plan tax-qualification purposes, of professional organizations, and certain related service organizations which furnish rank-and-file type support services.

The bill would change the controlled group rules insofar as they relate to professionals by requiring the aggregation, for qualified plan purposes, of a professional organization and any "adjunct professional organization" if (1) the professional organization regularly uses the services of, or is regularly associated in performing services with, the adjunct professional organization, (2) one or more of the professionals (or the owners of the professional organization) owns an interest in the adjunct organization, and (3) such individuals, as a group, own at least 25 percent of the adjunct organization. (The attribution rules of Code section 267, relating to transactions between related taxpayers, apply in determining ownership.) An adjunct professional organization is defined as an organization where the employees perform services for persons who perform professional services.

The bill limits its aggregation rules to situations where professional services are provided. For this purpose, professional services include services performed by physicians, dentists, chiropractors, osteopaths, optometrists, other licensed practitioners of the healing arts, attorneys at law, public accountants, public engineers, architects, draftsmen, actuaries, psychologists, social or physical scientists, and performing artists.

Effective date

Generally, the provisions of the bill would apply to plan years ending after December 13, 1979. In the case of a plan in existence on December 13, 1979, the bill would apply to plan years beginning after that date.

Revenue effect

It is estimated that this bill would increase budget receipts from the income tax by up to $50 million in fiscal year 1980 and by substantially larger amounts in the later years. In addition, the bill would eventually increase budget receipts from estate tax by significant amounts.

5. H.R. 6247—Mr. Gibbons

Treatment of Certain Community Income for Spouses Living Apart

Present law

Under present law, income considered community property under State law generally is taxed in equal shares to a husband and wife. Consequently, if a husband and wife file separate reurtns, each is required to report one-half of the community income. Generally, no special exception is made to this treatment for spouses who live apart. In certain cases, an abanndoned spouse may have to report a share of the community income earned by the other spouse although the abandoned spouse has not actually received any of the income.

Issue

The issue is whether, in limited circumstances, community income should not be included in gross income equally by a husband and wife for income tax purposes when they are living apart.

Explanation of the bill

If certain requirements are met, the bill would disregard State community property laws with respect to certain types of income for Federal income tax purposes. For purposes of the bill, a couple must be married at some time during the calendar year, but live apart during the entire calendar year and not file a joint return with respect to a taxable year beginning or ending in the calendar year. In addition, the spouses must have earned income for the calendar year that is community income, and no portion of that earned income must have been transferred directly or indirectly between the spouses during the calendar year.

If the requirements are met, any community income of the spouses for the calendar year would be allocated in accordance with Code section 879(a). In particular, that section provides that, generally, earned income is, for tax purposes, the income of the spouse who rendered the personal services.

Effective date

The provisions of the bill would apply to calendar years beginning after December 31, 1979.

Revenue effect

It is estimated that this bill would have a negligible effect on budget receipts.

6. H.R. 6824—Mr. Cotter

Nonqualified Deferred Compensation Arrangements Maintained by Tax-Exempt Organizations

Present law

In 1978, the Internal Revenue Service issued proposed regulations [1] which provide generally that if, under a plan or arrangement (other than a qualified retirement plan), payment of an amount of a taxpayer's fixed, basic, or regular compensation is deferred at the taxpayer's individual election to a taxable year later than that in which the amount would have been payable but for the election, the deferred amount will be treated as received in the earlier taxable year. These proposed regulations would have applied to plans maintained by State and local governments, as well as plans maintained by tax-exempt organizations and taxable employers.

The proposed regulations were not finalized because the Revenue Act of 1978 contained provisions relating to deferred compensation arrangements maintained by State or local governments and by taxable employers.

With respect to plans maintained by a State or local government, the 1978 Act prescribed annual limitations and eligibility requirements under which amounts deferred by an employee or independent contractor are includible in income only when paid or otherwise made available to the employee or independent contractor (sec. 131 of the Act and Code sec. 457). With respect to a deferred compensation plan maintained by a taxable employer, the 1978 Act provided that the taxable year for inclusion of amounts deferred under the plan is to be determined in accordance with the principles set forth in regulations, rulings, and judicial decisions relating to deferred compensation which were in effect on February 1, 1978. It was intended that these principles are to be determined without regard to the proposed deferred compensation regulation under Code section 61 which was published in the Federal Register for February 3, 1978.

Neither of the provisions enacted under the 1978 Act dealt with the treatment of nonqualified deferred compensation arrangements maintained by tax-exempt organizations.

Issue

The issue is whether the legislation enacted in 1978 with respect to unfunded nonqualified deferred compensation plans maintained either by State or local governments or by taxable employers should be extended to such plans maintained by tax-exempt employers.

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[1] Prop. Regs. § 1.61–16, published in the *Federal Register* for February 3, 1978 (43 F.R. 4638).

Explanation of the bill

Under the bill, the taxable year of inclusion in gross income by an employee of any amount covered by an unfunded nonqualified deferred compensation plan maintained by a tax-exempt organization is to be determined in the same manner as for a taxable employer. Thus, the year of inclusion would be determined in accordance with the principles set forth in regulations, rulings, and judicial decisions in effect on February 1, 1978, and without regard to the Treasury regulations proposed on February 3, 1978.

Effective date

The provision would be effective for taxable years ending on or after February 1, 1978.

Revenue effect

It is estimated that this bill would have a negligible effect on budget receipts.

7. H.R. 7009—Messrs. Rostenkowski, Stark, Lederer, Fowler, Duncan (Tenn.), and Vander Jagt

Income Tax Exclusion for Certain Federal Scholarship Grants

Present law

Code section 117 provides that amounts received as scholarships at educational institutions and amounts received as fellowship grants generally are excluded from gross income. This exclusion also applies to incidental amounts received to cover expenses for travel, research, clerical help, and equipment. However, the exclusion for scholarships and fellowship grants is restricted to educational grants by relatively disinterested grantors who do not require any significant consideration from the recipient. Educational grants are not excludible from gross income if they represent compensation for past, present, or future services, or if the studies or research are primarily for the benefit of the grantor or are under the direction or supervision of the grantor (Treas. Reg. § 1.117–4(c)).

Special legislation provides that members of a uniformed service participating in the Armed Forces Health Professions Scholarship Program, the Public Health Services program, and similar programs may exclude from gross income amounts received as scholarships under these programs. Participants in these programs must agree to work for their funding service after completion of their studies. This temporary exclusion will not apply to scholarships awarded students entering these programs after December 31, 1980. (This temporary exclusion was most recently extended by P.L. 96–167, enacted as part of H.R. 5224.)

Issue

The issue is whether, on a permanent basis, Federal scholarships conditioned on the recipients' future services as Federal employees should be includible or totally or partially excludable from gross income.

Explanation of the bill

The bill would provide that an amount, which is received by an individual as a grant under a Federal program and which would be excludible from gross income as a scholarship or fellowship grant, but for the fact that the recipient must perform future service as a Federal employee, would not be includible in gross income if the individual establishes that the amount was used for qualified tuition and related expenses.

The excludible qualified tuition and related expenses would be the amount used for tuition and fees required for the enrollment or attendance of the student at an institution of higher education and for fees, books, supplies, and equipment required for courses of instruction at that institution.

The bill would define an "institution of higher education" as a public or other nonprofit educational institution in any State which: (1) admits as regular students only individuals who have a certificate of graduation from a high school (or the recognized equivalent of such a certificate); (2) is legally authorized within the State to provide a program of education beyond high school; and (3) provides an educational program for which it awards a bachelor's or higher degree, provides a program which is acceptable for full credit toward such a degree, or offers a program of training to prepare students for gainful employment in a recognized health profession.

Effective date

The exclusion provided by the bill would apply to taxable years beginning after December 31, 1980.

Revenue effect

It is estimated that this bill would reduce budget receipts by $8 million in fiscal year 1981, $17 million in fiscal year 1982, and $21 million in fiscal year 1984.