

**DESCRIPTION OF MANAGERS' AMENDMENT TO
THE REVENUE PROVISIONS OF H.R. 3448
(THE SMALL BUSINESS JOB PROTECTION ACT OF 1996)
AS REPORTED BY THE SENATE FINANCE COMMITTEE**

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of the

JOINT COMMITTEE ON TAXATION

July 9, 1996

JCX-34-96

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INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the Senate Majority and Minority Managers' amendment to the revenue provisions of H.R. 3448 (the "Small Business Job Protection Act of 1996") as reported by the Senate Finance Committee (see S. Rept. 104-281, June 18, 1996). The revenue provisions are contained in Title I of H.R. 3448.

Part I of this document is a description of the Managers' amendment relating to small business and other tax provisions, and Part II is a description of the amendment relating to revenue offsets.

¹ This document may be cited as follows: Joint Committee on Taxation, Description of Managers' Amendment to the Revenue Provisions of H.R. 3448 (the Small Business Job Protection Act of 1996) as Reported by the Senate Finance Committee (JCX-34-96), July 9, 1996.

I. SMALL BUSINESS PROVISIONS AND OTHER TAX PROVISIONS

A. Small Business Provisions

1. Treatment of dues paid to agricultural or horticultural organizations (sec. 1113 of the bill)

Present Law

Tax-exempt organizations generally are subject to the unrelated business income tax ("UBIT") on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511-514). Dues payments made to a membership organization generally are not subject to the UBIT. However, several courts have held that, with respect to postal labor organizations, dues payments were subject to the UBIT when received from individuals who were not postal workers, but who became "associate" members for the purpose of obtaining health insurance available to members of the organization. See National League of Postmasters of the United States v. Commissioner, No. 95-2646 (4th Cir. June 14, 1996); American Postal Workers Union, AFL-CIO v. United States, 925 F.2d 480 (D.C. Cir. 1991); National Association of Postal Supervisors v. United States, 944 F.2d 859 (Fed. Cir. 1991).

In Rev. Proc. 95-21 (issued March 23, 1995), the IRS set forth its position regarding when associate member dues payments received by an organization described in section 501(c)(5) will be treated as subject to the UBIT. The IRS stated that dues payments from associate members will not be treated as subject to UBIT unless, for the relevant period, "the associate member category has been formed or availed of for the principal purpose of producing unrelated business income." Thus, under Rev. Proc. 95-21, the focus of the inquiry is upon the organization's purposes in forming the associate member category (and whether the purposes of that category of membership are substantially related to the organization's exempt purposes other than through the production of income) rather than upon the motive of the individuals who join as associate members.

Description of Amendment

Under section 1113 of the bill and under the amendment, if an agricultural or horticultural organization described in section 501(c)(5) requires annual dues not exceeding \$100 to be paid in order to be a member of such organization, then in no event will any portion of such dues be subject to the UBIT by reason of any benefits or privileges to which members of such organization are entitled. For taxable years beginning after 1995, the \$100 amount will be indexed for inflation. The term "dues" is defined as "any payment (whether or not designated as dues) which is required to be made in order to be recognized by the organization as a member of the organization." Thus, if a person is recognized as a member of an organization by virtue of having paid annual dues for his or her membership, then any subsequent payments made by that person during the year to purchase another membership in the same organization will not be

within the scope of the provision. Section 1113 of the bill applies to taxable years beginning after December 31, 1994.

Effective date. --The amendment applies to taxable years beginning after December 31, 1986. The amendment also provides transitional relief to agricultural or horticultural organizations that had a reasonable basis for not treating membership dues received prior to January 1, 1987, as unrelated business income. In such cases, no portion of such dues will be treated as derived from an unrelated trade or business.

2. Clarify employment tax status of certain fishermen (sec. 1114 of the bill)

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 income tax withholding on wages and for purposes of the Federal Insurance Contributions Act ("FICA") and the Federal Unemployment Tax Act ("FUTA") taxes if the operating crew of the boat normally consists of fewer than 10 individuals, the individual receives a share of the catch based on the total catch, and the individual does not receive cash remuneration other than proceeds from the sale of the individual's share of the catch. If a crew member receives any other cash, e.g., payment for services as an engineer, the exemption from FICA and FUTA taxes does not apply. Crew members to which the exemption applies are subject to self-employment taxes. Special reporting requirements apply to the operators of boats on which exempt crew members serve.

Description of Amendment

The Finance Committee bill provides that the operating crew of a boat is treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals. In addition, the exemption still applies even if the crew member receives certain cash payments. The cash payments cannot exceed \$100 per trip, must be contingent on a minimum catch, and must be paid solely for additional duties (e.g., as mate, engineer, or cook) for which additional cash remuneration is customary.

The provision in the Finance Committee bill is effective with respect to remuneration paid after December 31, 1994. It is intended that, with respect to years before the effective date, the Secretary apply the exemption in a manner consistent with the proposal.

The amendment would modify the effective date of the provision in the Finance Committee bill so that it is effective with respect to remuneration paid after December 31, 1994, and also is effective with respect to remuneration paid after December 31, 1984, and

before January 1, 1995, unless the payer treated such remuneration (when paid) as being subject to FICA taxes.

3. Modifications to section 530 of the Revenue Act of 1978 (sec. 1112 of the bill)

Present Law

In general

For Federal tax purposes, there are two classifications of workers: a worker is either an employee of the service recipient or an independent contractor. In general, the determination of whether an employer-employee relationship exists for Federal tax purposes is made under a common-law test. Treasury regulations provide that an employer-employee relationship generally exists if the person contracting for services has the right to control not only the result of the services, but also the means by which that result is accomplished.²

Section 530

With increased enforcement of the employment tax laws beginning in the late 1960s, controversies developed between the IRS and taxpayers as to whether businesses had correctly classified certain workers as self employed rather than as employees. In response to this problem, the Congress enacted section 530 of the Revenue Act of 1978 ("section 530"). That provision generally allows a taxpayer to treat a worker as not being an employee for employment tax purposes (but not income tax purposes), regardless of the individual's actual status under the common-law test, unless the taxpayer has no reasonable basis for such treatment.

Under section 530, a reasonable basis for treating a worker as an independent contractor is considered to exist if the taxpayer (1) reasonably relied on published rulings or judicial precedent, (2) reasonably relied on past IRS audit practice with respect to the taxpayer, (3) reasonably relied on long-standing recognized practice of a significant segment of the industry of which the taxpayer is a member, or (4) has any other reasonable basis for treating a worker as an independent contractor. The legislative history states that section 530 is to be "construed liberally in favor of taxpayers."³

² The Internal Revenue Service ("IRS") has developed a list of 20 factors that may be examined in determining whether an employer-employee relationship exists. Rev. Rul. 87-41, 1987-1 C.B. 296.

³ H. Rept. No. 1748 (95th Cong., 2d Sess., 5 (1978)). The conference agreement to the Revenue Act of 1978 adopted the provisions of the House bill and therefore incorporates this legislative history.

The relief under section 530 is available with respect to an individual only if certain additional requirements are satisfied. The taxpayer must not have treated the individual as an employee for any period, and for periods since 1978 all Federal tax returns, including information returns, must have been filed on a basis consistent with treating such individual as an independent contractor. Further, the taxpayer (or a predecessor) must not have treated any individual holding a substantially similar position as an employee for purposes of employment taxes for any period beginning after 1977.

Whether workers are similarly situated is dependent on the facts and circumstances. An IRS draft training guide⁴ states that a "substantially similar position exists if the job functions, duties, and responsibilities are substantially similar and the control and supervision of those duties and responsibilities is substantially similar."⁵

There have been a few court decisions addressing this issue. For example, in REAG, Inc. v. U.S.,⁶ the court held that the position of appraisers who were owner-officers of the business was not substantially similar to appraisers who were not owners since the owner-officers had managerial responsibilities. By contrast, in Lowen Corp. v. U.S.,⁷ the court found that all workers engaged in the business of selling real estate signs had substantially similar positions even though some were salaried and had to file daily reports while others were paid by commission and did not have to file such reports.

Under section 1706 of the Tax Reform Act of 1986, section 530 does not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work. Thus, the determination of whether such individuals are employees or self employed is made in accordance with the common-law test.

Description of Amendment

The amendment would provide some modifications to section 530 in addition to those in the Finance Committee bill.

⁴ Employee or Independent Contractor?, (Draft, February 28, 1996) (hereinafter the "IRS Draft Training Guide").

⁵ IRS Draft Training Guide, at 3-10.

⁶ 801 F.Supp. 494 (W.D. Okla. 1992). The IRS has not acquiesced. IRS Draft Training Guide, at 3-13.

⁷ 785 F.Supp. 913 (D. Kan. 1992).

The amendment would provide that the fact that a taxpayer changes its treatment of workers from independent contractors to employees would not affect the applicability of the safe harbor for prior periods.

In addition, the amendment would provide that, in determining whether a worker holds a substantially similar position to another worker, the relationship of the parties must be one of the factors taken into account.

Effective date.--The amendment would be effective with respect to periods after December 31, 1996.

B. Expiring Provisions

1. Employer-provided educational assistance (sec. 1202 of the bill)

Present and Prior Law

For taxable years beginning before January 1, 1995, an employee's gross income and wages did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements. This exclusion, which expired for taxable years beginning after December 31, 1994, was limited to \$5,250 of educational assistance with respect to an individual during a calendar year. The exclusion applied whether or not the education was job related. In the absence of this exclusion, educational assistance is excludable from income only if it is related to the employee's current job.

Description of Amendment

The bill extends the exclusion for employer-provided educational assistance (including the application of the exclusion to graduate education) for taxable years beginning after December 31, 1994, and before January 1, 1997.

The amendment would extend the exclusion an additional year, through December 31, 1997.

2. Research and experimentation tax credit (sec. 1203 of the bill)

Present and Prior Law

General rule

Prior to July 1, 1995, section 41 of the Internal Revenue Code provided for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified

research expenditures for a taxable year exceeded its base amount for that year. The research tax credit expired and does not apply to amounts paid or incurred after June 30, 1995.

A 20-percent research tax credit also applied to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the "university basic research credit" (see sec. 41(e)).

Computation of allowable credit

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of 3 percent.⁸

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

⁸ The Omnibus Budget Reconciliation Act of 1993 included a special rule designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm (i.e., any taxpayer that did not have gross receipts in at least three years during the 1984-1988 period) will be assigned a fixed-base percentage of 3 percent for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. In the event that the research credit is extended beyond the scheduled June 30, 1995 expiration date, a start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenditures will be a phased-in ratio based on its actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage will be its actual ratio of qualified research expenditures to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993 (sec. 41(c)(3)(B)).

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, research expenditures and gross receipts of the taxpayer are aggregated with research expenditures and gross receipts of certain related persons for purposes of computing any allowable credit (sec. 41(f)(1)). Special rules apply for computing the credit when a major portion of a business changes hands, under which qualified research expenditures and gross receipts for periods prior to the change or ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage (sec. 41(f)(3)).

Eligible expenditures

Qualified research expenditures eligible for the research tax credit consist of: (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses").

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must pertain to functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors (sec. 41(d)(3)). In addition, research does not qualify for the credit if conducted after the beginning of commercial production of the business component, if related to the adaptation of an existing business component to a particular customer's requirements, if related to the duplication of an existing business component from a physical examination of the component itself or certain other information, or if related to certain efficiency surveys, market research or development, or routine quality control (sec. 41(d)(4)).

Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

Description of Amendment

Section 1203 of the bill extends the research tax credit for 12 months--i.e., for the period July 1, 1996, through June 30, 1997. The amendment extends the research tax credit for 18 months--i.e., for the period July 1, 1996, through December 31, 1997 (with a special rule for taxpayers who elect the alternative incremental research credit regime, as described below).

The bill and the amendment also expand the definition of "start-up firms" under section 41(c)(3)(B)(I) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983.⁹

In addition, the bill and the amendment allow taxpayers to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative credit regime, a credit rate of 1.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1 percent (i.e., the base amount equals 1 percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 2.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of 2 percent. A credit rate of 2.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 2 percent. An election to be subject to this alternative incremental credit regime may be made only for a taxpayer's first taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years unless revoked with the consent of the Secretary of the Treasury. Under the amendment, if a taxpayer elects the alternative incremental credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, then all qualified research expenses paid or incurred during such taxable year and the first six months of the following taxable year are treated as qualified research expenses for purposes of computing the taxpayer's credit under the alternative incremental credit regime.

The bill and the amendment also provide for a special rule for payments made to certain nonprofit research consortia. Under this special rule, 75 percent of amounts paid to a research consortium for qualified research is treated as qualified research expenses eligible for the research credit (rather than 65 percent under the present-law section 41(b)(3) rule governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer.

⁹ In applying the start-up firm rules, the test is whether a taxpayer, in fact, both incurred research expenses (which under the present-law rules would be qualified research expenses) and had gross receipts in a particular year, not whether the taxpayer claimed a research tax credit for that year.

Effective date.--Under the amendment, extension of the research tax credit is effective for expenditures paid or incurred during the period July 1, 1996, through December 31, 1997 (with a special rule for taxpayers who elect the alternative incremental research credit regime). The modification to the definition of "start-up firms" is effective for taxable years ending after June 30, 1996. Taxpayers may elect the alternative research credit regime (with lower fixed-base percentages and lower credit rates) for the first taxable year beginning after June 30, 1996, and before July 1, 1997, and the credit is available with respect to all qualified research expenses incurred during such taxable year and during the first six months of the following taxable year. The rule that treats 75 percent of qualified research consortium payments as qualified research expenses is effective for taxable years beginning after June 30, 1996.

3. Orphan drug tax credit (sec. 1204 of the bill)

Present and Prior Law

Prior to January 1, 1995, a 50-percent nonrefundable tax credit was allowed for qualified clinical testing expenses incurred in testing of certain drugs for rare diseases or conditions, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA. A rare disease or condition is defined as one that (1) affects less than 200,000 persons in the United States, or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for such disease or condition from U.S. sales of the drug. These rare diseases and conditions include Huntington's disease, myoclonus, ALS (Lou Gehrig's disease), Tourette's syndrome, and Duchenne's dystrophy (a form of muscular dystrophy).

Under prior law, the orphan drug tax credit could be claimed by a taxpayer only to the extent that its regular tax liability for the year the credit was earned exceeded its tentative minimum tax for that year, after regular tax was reduced by nonrefundable personal credits and the foreign tax credit.¹⁰ Unused credits could not be carried back or carried forward to reduce taxes in other years.

The orphan drug tax credit expired after December 31, 1994.

Description of Amendment

Section 1204 of the bill extends the orphan drug tax credit for 12 months--i.e., for the period July 1, 1996, through June 30, 1997. The amendment would extend the orphan

¹⁰ To the extent that the orphan drug tax credit could not be used by reason of the minimum tax limitation, the taxpayer's minimum tax credit was increased (sec. 53(d)(1)(B)(iii)).

drug tax credit for 18 months--i.e., for the period July 1, 1996, through December 31, 1997.

In addition, the bill and the amendment allow taxpayers to carry back unused credits to three years preceding the year the credit is earned and to carry forward unused credits to 15 years following the year the credit is earned.

Effective date.--The amendment would apply to qualified clinical testing expenses paid or incurred during the period July 1, 1996, through December 31, 1997. The provision allowing for the carry back and carry forward of unused credits would be effective for taxable years ending after June 30, 1996. No portion of the unused business credit that is attributable to the orphan drug credit could be carried back under section 39 to a taxable year ending before July 1, 1996.

4. Contributions of stock to private foundations (sec. 1205 of the bill)

Present and Prior Law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization.¹¹ However, in the case of a charitable contribution of short-term gain, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose.¹²

In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the

¹¹ The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)).

¹² As part of the Omnibus Budget Reconciliation Act of 1993, Congress eliminated the treatment of contributions of appreciated property (real, personal, and intangible) as a tax preference for alternative minimum tax (AMT) purposes. Thus, if a taxpayer makes a gift to charity of property (other than short-term gain, inventory, or other ordinary income property, or gifts to private foundations) that is real property, intangible property, or tangible personal property the use of which is related to the donee's tax-exempt purpose, the taxpayer is allowed to claim the same fair-market-value deduction for both regular tax and AMT purposes (subject to present-law percentage limitations).

property. However, under a special rule contained in section 170(e)(5), taxpayers were allowed a deduction equal to the fair market value of "qualified appreciated stock" contributed to a private foundation prior to January 1, 1995. Qualified appreciated stock was defined as publicly traded stock which is capital gain property. The fair-market-value deduction for qualified appreciated stock donations applied only to the extent that total donations made by the donor to private foundations of stock in a particular corporation did not exceed 10 percent of the outstanding stock of that corporation. For this purpose, an individual was treated as making all contributions that were made by any member of the individual's family. This special rule contained in section 170(e)(5) expired after December 31, 1994.

Description of Amendment

Section 1205 of the bill extends the special rule contained in section 170(e)(5) for 12 months--i.e., for contributions of qualified appreciated stock made to private foundations for contributions made during the period July 1, 1996, through June 30, 1997. The amendment extends the special rule contained in section 170(e)(5) for 18 months--i.e., for contributions of qualified appreciated stock made to private foundations for contributions made during the period July 1, 1996, through December 31, 1997.¹³

Effective date.--The amendment is effective for contributions of qualified appreciated stock to private foundations made during the period July 1, 1996, through December 31, 1997.

5. Tax credit for producing fuel from a nonconventional source (sec. 1206 of the bill)

Present Law

Certain fuels produced from "nonconventional sources" and sold to unrelated parties are eligible for an income tax credit equal to \$3 (generally adjusted for inflation) per barrel or BTU oil barrel equivalent (sec. 29) (referred to as the "section 29 credit"). Qualified fuels must be produced within the United States. Qualified fuels include:

- (1) oil produced from shale and tar sands;
- (2) gas produced from geopressured brine, Devonian shale, coal seams, tight formations ("tight sands"), or biomass; and
- (3) liquid, gaseous, or solid synthetic fuels produced from coal (including lignite).

¹³ If, during this period, a taxpayer contributes qualified appreciated stock as defined in section 170(e)(5) and the amount of such contribution exceeds the percentage limitation under section 170(b)(1)(D), the excess may be carried over to succeeding taxable years. See, e.g., LTR 9444029, LTR 9424020.

In general, the credit is available only with respect to fuels produced from wells drilled or facilities placed in service after December 31, 1979, and before January 1, 1993. An exception extends the January 1, 1993 expiration date for facilities producing gas from biomass and synthetic fuel from coal if the facility producing the fuel is placed in service before January 1, 1997, pursuant to a binding contract entered into before January 1, 1996.

The credit may be claimed for qualified fuels produced and sold before January 1, 2003 (in the case of nonconventional sources subject to the January 1, 1993 expiration date) or January 1, 2008 (in the case of biomass gas and synthetic fuel facilities eligible for the extension period).

Description of Amendment

The Finance Committee reported bill extends the binding contract date for facilities producing synthetic fuels from coal and gas from biomass to the date which is six months after the date of the provision's enactment, and extends the placed-in-service date for one year (i.e., facilities placed in service before January 1, 1998). The present sunset on production qualifying for the credit is not changed.

The amendment would extend the placed-in-service date to January 1, 1999. Thus, under the amendment, synthetic fuels from coal and gas from biomass produced from a facility placed in service before January 1, 1999, pursuant to a binding contract entered into before the date which is six months after the date of the provision's enactment, would be eligible for the tax credit if produced before January 1, 2008.

Effective date.--Date of enactment.

6. Suspend imposition of diesel fuel tax on recreational motorboats (sec. 1207 of the bill)

Present Law

Diesel fuel used in recreational motorboats is subject to a 24.4 cents-per-gallon excise tax through December 31, 1999. This tax was enacted by the Omnibus Budget Reconciliation Act of 1993 as a revenue offset for repeal of the excise tax on certain luxury boats. Revenues from this tax are retained in the General Fund.

The diesel fuel tax is imposed on removal of the fuel from a registered terminal facility (i.e., at the "terminal rack"). Present law provides that tax is imposed on all diesel fuel removed from terminal facilities unless the fuel is destined for a nontaxable use and is indelibly dyed pursuant to Treasury Department regulations. If fuel on which tax is paid at the terminal rack (i.e., undyed diesel fuel) ultimately is used in a nontaxable use, a refund is allowed. Depending on the aggregate amount of tax to be refunded, this refund may be

claimed either by a direct filing with the Internal Revenue Service or as a credit against income tax.

Dyed diesel fuel (fuel on which no tax is paid) may not be used in a taxable use. Present law imposes a penalty equal to the greater of \$10 per gallon or \$1,000 on persons found to be violating this prohibition.

Description of Amendment

The Finance Committee reported bill provided that no tax would be imposed on diesel fuel used in recreational motorboats during the period July 1, 1996, through June 30, 1997, and requested that the Treasury Department study possible alternatives to the current collection regime for motorboat diesel fuel that will provide comparable compliance with the law, and report to the House Committee on Ways and Means and the Senate Committee on Finance no later than April 1, 1997.

Under the amendment, no tax would be imposed on diesel fuel used in recreational motorboats during the period beginning seven days after the date of enactment and ending on December 31, 1997.

Effective date.--The provision would be effective on the date of enactment.

7. Extension of transition rule for certain publicly traded partnerships

Present Law

Present law provides that, in general, a publicly traded partnership is treated as a corporation for Federal income tax purposes. An exception is provided for certain partnerships, 90 percent or more of whose gross income is passive-type income (as defined for purposes of the provision). A publicly traded partnership is any partnership if (1) partnership interests are traded on an established securities market, or (2) partnership interests are readily tradable on a secondary market (or the substantial equivalent). This provision was added by the Omnibus Budget Reconciliation Act of 1987 (the "1987 Act"), and applied generally to taxable years beginning after December 31, 1987.

The 1987 Act provided a 10-year grandfather rule for certain existing partnerships. Thus, the provision becomes effective for such existing partnerships for taxable years beginning after December 31, 1997. The 1987 Act provides that an existing partnership is one: (1) which was a publicly traded partnership on December 17, 1987; (2) with respect to which a registration statement indicating that such partnership was to be a publicly traded partnership was filed with the Securities and Exchange Commission on or before December 17, 1987, or (3) with respect to which an application was filed with a State regulatory commission on or before December 17, 1987 seeking permission to restructure a portion of a corporation as a publicly traded partnership. A partnership ceases to be

treated as an existing partnership if it adds a substantial new line of business after December 17, 1987.

Description of Amendment

The amendment would provide a 2-year extension of the 10-year grandfather rule for existing partnerships. Thus, the provision treating publicly traded partnerships as corporations would apply to existing partnerships for taxable years beginning after December 31, 1999.

Effective date.--The provision would take effect as if included in the 1987 Act.

C. Pension Simplification Provisions

1. Waiver of minimum waiting period for qualified plan distributions (sec. 1451 of the bill)

Present Law

Under present law, in the case of a qualified joint and survivor annuity ("QJSA"), a written explanation of the form of benefit must generally be provided to participants no less than 30 days and no more than 90 days before the annuity starting date. Temporary Treasury regulations provide that a plan may permit a participant to elect (with any applicable spousal consent) a distribution with an annuity starting date before 30 days have elapsed since the explanation was provided, as long as the distribution commences more than seven days after the explanation was provided.

Description of Amendment

The amendment would strike section 1451 of the bill, which provides that the minimum period between the date the explanation of the QJSA is provided and the annuity starting date does not apply if it is waived by the participant and, if applicable, the participant's spouse.

2. Expansion of PBGC missing participant program

Present Law

The Retirement Protection Act ("RPA"), enacted as part of the legislation implementing the General Agreement on Tariffs and Trade ("GATT") in 1994, provided special rules for the payment of benefits with respect to missing participants under a terminating single-employer defined benefit plan covered by the Pension Benefit Guaranty Corporation ("PBGC"). These rules generally require the plan administrator to (1) transfer the missing participant's designated benefit to the PBGC or purchase an annuity from an

insurer to satisfy the benefit liability, and (2) provide the PBGC with such information and certifications with respect to the benefits or annuity as the PBGC may specify. The missing participant program does not apply to multiemployer defined benefit plans, defined contribution plans, and defined benefit plans not covered by the PBGC (generally governmental plans, church plans, and plans sponsored by professional service employers with less than 25 employees).

Description of Amendment

The missing participant program would generally be expanded to be available to multiemployer defined benefit plans, defined contribution plans, and defined benefit plans not covered by the PBGC (other than governmental and church plans). Under the amendment, the present-law missing participant program applicable to single-employer defined benefit plans would apply to a terminating multiemployer defined benefit plan under rules prescribed by the PBGC.

In the case of a terminating defined contribution plan or a terminating defined benefit plan not covered by the PBGC, the missing participant program would not apply unless the plan elects to transfer a missing participant's benefits to the PBGC. To the extent provided in regulations issued by the PBGC, the administrator of the plan making such an election would be required to provide the PBGC with information with respect to the benefits of a missing participant. Upon location of the missing participant, the missing participant's benefits would be paid by the PBGC in a lump sum or in such other form as specified in regulations.

Effective date.--The amendment would be effective with respect to distributions made on or after the date final regulations implementing the proposal are issued by the PBGC.

3. Alternative nondiscrimination rules for certain plans that provide for early participation

Present Law

Under present law, a special nondiscrimination test applies to qualified cash or deferred arrangements (sec. 401(k) plans). The special nondiscrimination test is satisfied if the actual deferral percentage ("ADP") for eligible highly compensated employees for a plan year is equal to or less than either (1) 125 percent of the ADP of all nonhighly compensated employees eligible to defer under the arrangement or (2) the lesser of 200 percent of the ADP of all eligible nonhighly compensated employees or such ADP plus 2 percentage points. Employer matching contributions and after-tax employee contributions under qualified defined contribution plans are subject to a special nondiscrimination test (the actual contribution percentage ("ACP") test) similar to the special nondiscrimination test applicable to qualified cash or deferred arrangements.

In general, a plan need not permit employees to enter a plan prior to the attainment of age 21 and the completion of 1 year of service. For purposes of the nondiscrimination rules (including the ADP and ACP tests), an employer that chooses less restrictive entry conditions (e.g., age 18 rather than age 21) may choose "separate testing" under which all employees who have not met the statutory age and service entry maximums are disregarded, provided that the plan satisfies the nondiscrimination rules taking into account only those employees whose age and service are less than the statutory age and service maximums. Thus, for example, such a plan would apply one ADP test for employees who are over age 21 with 1 year of service, under which the plan would disregard elective contributions for other employees, and a second ADP test looking solely at elective contribution for employees under age 21 or who have not completed 1 year of service.

Description of Amendment

Under the amendment, for purposes of the ADP test, a section 401(k) plan could elect to ignore employees (other than highly compensated employees) eligible to participate before they have completed 1 year of service and reached age 21, provided the plan separately satisfies the minimum coverage rules of section 410(b) taking into account only those employees who have not completed 1 year of service or are under age 21. Instead of applying two separate ADP tests, such a plan could apply a single ADP test that compares the ADP for all highly compensated employees who are eligible to make elective contributions with the ADP for those nonhighly compensated employees who are eligible to make elective contributions and who have completed one year of service and reached age 21. A similar rule would apply for purposes of the ACP test.

Effective date.--The amendment would be effective for plan years beginning after December 31, 1998.

4. Modifications of joint and survivor annuity requirements

Present Law

Present law contains a number of rules designed to provide income to the surviving spouse of a deceased employee. These rules are in both the Internal Revenue Code and title I of the Employee Retirement Income Security Act of 1974, as amended.

Under the spousal protection rules, defined benefit pension plans and money purchase pension plans are required to provide that vested retirement benefits with a present value in excess of \$3,500 are payable in the form of a qualified joint and survivor annuity ("QJSA") or, in the case of a participant who dies before the annuity starting date, a qualified preretirement survivor annuity ("QPSA"). A QJSA is generally defined as an annuity for the life of the participant with a survivor annuity for the life of the spouse which is not less than 50 percent of (and not greater than 100 percent of) the amount of the participant's annuity, and which is the actuarial equivalent of a single life annuity for the

life of the participant. A QPSA is generally defined as an annuity for the life of the surviving spouse of the participant, the payments of which are not less than the amount which would be payable as a survivor annuity under the plan's QJSA.

The survivor benefit rules do not apply to defined contribution plans other than money purchase pension plans if (1) the plan provides that, upon the death of the participant, the participant's accrued benefit is payable to the participant's surviving spouse, (2) the participant does not elect payment of benefits in the form of an annuity, and (3) the plan is not a transferee plan of a plan subject to the joint and survivor rules.

Benefits from a plan subject to the survivor benefit rules may be paid in a form other than a QJSA or QPSA if the participant waives the QJSA or QPSA and the applicable notice, election, and spousal consent requirements are satisfied. Similarly, under a defined contribution plan not subject to the survivor benefit rules, the spouse can consent to have benefits paid to another beneficiary.

Description of Amendment

Under the amendment, if a plan provides as its QJSA a benefit which provides a survivor annuity for the life of the spouse which is not equal to 66 2/3 percent of the amount of the participant's annuity, the plan would be required to provide the participant with an election to receive an annuity for the life of the participant with a survivor annuity for the life of the spouse which is 66 2/3 percent of the amount of the participant's annuity.¹⁴ If the participant makes such an election, the benefit received would be treated as a QJSA for purposes of the qualified plan requirements; however, the fact that such an election is offered would not affect how the QPSA is calculated. In other words, the QPSA would continue to be based on the regular QJSA currently provided under the plan.

Effective date.--The amendment would be effective for plan years beginning after December 31, 1996. However, plans in existence on the date of enactment would not have to comply with the requirements of the amendment before the plan year immediately following the first plan year in which an amendment to the plan that is otherwise made becomes effective.

5. Clarification of application of ERISA to insurance company general accounts

Present Law

Part 4, subtitle B, of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA") imposes certain fiduciary requirements (including restrictions on certain

¹⁴ As with the QJSA, this benefit would be the actuarial equivalent of a single life annuity for the life of the participant.

prohibited transactions) with respect to the assets of an employee benefit plan ("plan assets"). Section 4975 of the Internal Revenue Code of 1986 (the "Code") imposes an excise tax in the case of certain prohibited transactions involving plan assets.

In 1975, the Department of Labor issued Interpretive Bulletin 1975-2 which provided that if an insurance company issues a contract or policy of insurance to an employee benefit plan and places the consideration of such contract or policy in its general asset account, the assets in such account are not considered to be plan assets.¹⁵ However, on December 13, 1993, the Supreme Court, in John Hancock Mutual Life Insurance Company v. Harris Trust and Savings Bank,¹⁶ ruled that certain assets held in an insurance company's general account should be considered plan assets.

Description of Amendment

Under the amendment, not later than December 31, 1996, the Secretary of Labor would be required to issue proposed regulations providing guidance for the purpose of determining, in cases where an insurer issues 1 or more policies (supported by the assets of the insurer's general account) to or for the benefit of an employee benefit plan, which assets of the insurer (other than plan assets held in its separate account) constitute plan assets for purposes of ERISA and the Code. Such proposed regulations would be subject to public notice and comment until March 31, 1997, and the Secretary of Labor would be required to issue final regulations by June 30, 1997. Any regulations issued by the Secretary of Labor in accordance with the amendment could not take effect before the date on which such regulations became final.

In issuing regulations, the Secretary of Labor would have to ensure that such regulations are administratively feasible and are designed to protect the interests and rights of the plan and of the plan's participants and beneficiaries. In so doing, the Secretary of Labor may exclude any assets of the insurer with respect to its operations, products, or services from treatment as plan assets. Further, the regulations would have to provide that plan assets do not include assets which are not treated as plan assets under present-law ERISA by reason of being (1) assets of an investment company registered under the Investment Company Act of 1940, and (2) assets of an insurer with respect to a guaranteed benefit policy issued by such insurer.

¹⁵ 29 CFR section 2509.75-2(b) (1992). The term "general account" refers to all assets of an insurance company which are not legally segregated and allocated to separate accounts. The assets in a general account are derived from all classes of business and support the insurers' obligations on an unsegregated basis, with no particular assets being specifically committed to meet the obligations under any particular contract or policy.

¹⁶ 510 U.S. 86 (1993).

Under the amendment, no person would be liable under ERISA or the Code for conduct which occurred prior to the date which is 18 months following the effective date of the final regulations on the basis of a claim that the assets of the insurer (other than plan assets held in a separate account) constituted plan assets, except as otherwise provided by the Secretary of Labor in order to prevent avoidance of the guidance in the regulations or as provided in an action brought by the Secretary of Labor under ERISA's enforcement provisions for a breach of fiduciary responsibility which would also constitute a violation of Federal criminal law or constitute a felony under applicable State law.¹⁷

The amendment would not preclude the application of any Federal criminal law.

Effective date.--The amendment generally would be effective on January 1, 1975. However, the amendment would not apply to any civil action commenced before November 7, 1995.

6. Church pension plan simplification

Present Law

In general, a church plan is a plan established and maintained for employees (or their beneficiaries) by a church or a church convention or association of churches that is exempt from tax (sec. 414(e)). Church plans include plans maintained by an organization, whether a corporation or otherwise, that has as its principal purpose or function the administration or funding of a plan or program for providing retirement or welfare benefits for the employees of the church or convention or association of churches. Employees of a church include any minister, regardless of the source of his or her compensation, and an employee of an organization which is exempt from tax and which is controlled by or associated with a church or a convention or association of churches.¹⁸

Plans maintained by churches and certain church-controlled organizations are exempt from certain of the requirements applicable to pension plans under the Code pursuant to the Employee Retirement Income Security Act of 1974 (as amended) ("ERISA"). For example, such plans are not subject to ERISA's vesting, coverage, and funding requirements. In some cases, such plans are subject to provisions in effect before the enactment of ERISA. Under the rules in effect before ERISA, a plan cannot discriminate in favor of officers, shareholder, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees. Church plans

¹⁷ The amendment would provide that the term policy includes a contract.

¹⁸ With respect to certain provisions (e.g., the exemption for church plans from nondiscrimination requirements applicable to tax-sheltered annuities), the more limited definition of church under the employment tax rules applies (secs. 3121(w)(3)(A) and (B)).

may elect to waive the exemption from the qualification rules (sec. 410(d)). Electing plans become subject to all the tax Code (sec. 401(a)) qualification requirements, Title I of ERISA, the excise tax on prohibited transactions, and participation in the pension plan termination insurance program administered by the Pension Benefit Guaranty Corporation.

Certain eligible employers may maintain tax-sheltered annuity plans (sec. 403(b)). These plans provide tax-deferred retirement savings for employees of public education institutions and employees of certain tax-exempt organizations (including churches and certain organizations associated with churches). In addition to tax-sheltered annuities, alternative funding mechanisms that provide similar tax benefits include church-maintained retirement income accounts (sec. 403(b)(9)).

For purposes of determining an employee's investment in the contract under the rules relating to taxation of annuities, amounts contributed by the employer are included as investment in the contract, but only to the extent that such amounts were includible in the gross income of the employee or, if such amounts had been paid directly to the employee, would not have been includible in income. However, amounts contributed by the employer which, if they had been paid directly to the employee, would have been excludable under section 911 are not treated as investment in the contract, except to the extent attributable to services performed before January 1, 1963.

Description of Amendment

The amendment would allow self-employed ministers to participate in a church plan. For purposes of the definition of a church plan, a self-employed minister would be treated as his or her own employer and as if the employer were a tax-exempt organization under section 501(c)(3). The earned income of the self-employed minister would be treated as his or her compensation. Self-employed ministers would be able to deduct their contributions.

In addition, ministers employed by an organization other than a church would be treated as if employed by a church. Thus, such ministers could also participate in a church plan. The amendment would provide that if a minister is employed by an employer that is not eligible to maintain a church plan, the minister would not be taken into account by that employer in applying nondiscrimination rules.

The amendment would permit retirement income accounts to be established for self-employed ministers.

The amendment would provide that church plans subject to the pre-ERISA nondiscrimination rules apply the same definition of highly compensated employee as other pension plans, rather than the pre-ERISA rule relating to employees who are officers,

shareholders, persons whose principal duties consist of supervising the work of other employees or highly compensated employees.

The amendment would provide that the Secretary of the Treasury may develop safe harbor rules for church plans under the applicable coverage and nondiscrimination rules.

The amendment would provide that, in the case of foreign missionaries, amounts contributed to a plan by the employer are investment in the contract even though the amounts, if paid directly to the employee would have been excludable under section 911.

Effective date.--The amendment would be effective for years beginning after December 31, 1996.

7. Increase in multiemployer plan benefits guaranteed

Present Law

The Pension Benefit Guaranty Corporation ("PBGC") guarantees benefits of workers in multiemployer plans. The monthly guarantee is equal to the participant's years of service multiplied by the sum of (1) 100 percent of the first \$5 of the monthly benefit accrual rate, and (2) 75 percent of the next \$15 of the accrual rate.

Description of Amendment

The amendment would generally adjust the amount guaranteed in multiemployer plans to account for changes in the Social Security wage index since 1980. Under the amendment, the PBGC would guarantee a monthly benefit equal to the participant's years of service multiplied by the sum of (1) 100 percent of the first \$11 of the monthly benefit accrual rate, and (2) 75 percent of the next \$33 of the accrual rate. The amendment would increase the maximum annual guarantee for a retiree with 30 years of service to \$12,870.

The changes to the benefits guaranteed in multiemployer plans made by the amendment would only apply in the case of multiemployer plans which first receive financial assistance from the PBGC during the applicable period. The applicable period would be the period beginning on the date of enactment and ending on the last day of the first fiscal year in which the surplus in the PBGC's multiemployer insurance program, as reflected in the Statement of Financial Condition for the fiscal year ending September 30, 1995 in the PBGC's 1995 Annual Report, declines by more than 50 percent. The benefits of participants in multiemployer plans that first received financial assistance from the PBGC during the applicable period would not be affected. In determining whether the surplus in the multiemployer insurance program declined by more than 50 percent in any fiscal year, the PBGC would be required to use the same actuarial assumptions that it used in determining the surplus for the fiscal year ending September 30, 1995. If the benefits guaranteed in multiemployer plans are reduced to their present law levels as a result of a

more than 50 percent decline in the surplus in the multiemployer insurance program, Congress would need to enact new legislation to increase the level of guaranteed benefits.

Effective date.--The amendment would be effective on the date of enactment.

8. Waiver of excise tax on failure to pay liquidity shortfall

Present Law

A provision in the Retirement Protection Act of 1994, enacted as part of the implementing legislation for the General Agreement on Tariffs and Trade ("GATT"), generally requires certain underfunded single-employer defined benefit plans to make quarterly contributions sufficient to maintain liquid plan assets, i.e., cash and marketable securities, at an amount approximately equal to three times the total trust disbursements for the preceding 12-month period. This liquidity requirement only applies to underfunded single-employer defined benefit plans (other than small plans)¹⁹ that (1) are required to make quarterly installments of their estimated minimum funding contribution for the plan year, and (2) have a liquidity shortfall for any quarter during the plan year.

A plan has a liquidity shortfall if its liquid assets as of the last day of the quarter are less than the base amount for the quarter. Liquid assets are cash, marketable securities and such other assets as specified by the Secretary. The base amount for the quarter is an amount equal to the product of three times the adjusted disbursements from the plan for the 12 months ending on the last day of the last month preceding the quarterly installment due date. If the base amount exceeds the product of two times the sum of adjusted disbursements for the 36 months ending on the last day of the last month preceding the quarterly installment due date, and an enrolled actuary certifies to the satisfaction of the Secretary that the excess is the result of nonrecurring circumstances, such nonrecurring circumstances are not included in the base amount. For purposes of determining the base amount, adjusted disbursements mean the amount of all disbursements from the plan's trust, including purchases of annuities, payments of single sums, other benefit payments, and administrative expenses reduced by the product of the plan's funded current liability percentage for the plan year and the sum of the purchases of annuities, payments of single sums, and such other disbursements as the Secretary provides in regulations.

The amount of the required quarterly installment for defined benefit plans that have a liquidity shortfall for any quarter is the greater of the quarterly installment or the liquidity shortfall. The amount of the liquidity shortfall must be paid in the form of liquid assets. It may not be paid by the application of credit balances in the funding standard account. The amount of any liquidity shortfall payment when added to prior installments

¹⁹ A plan is a small plan if it had 100 or fewer participants on each day during the plan year (as determined in Code sec. 412(1)(6)).

for the plan year cannot exceed the amount necessary to increase the funded current liability percentage of the plan to 100 percent taking into account the expected increase in current liability due to benefits accruing during the plan year.

If a liquidity shortfall payment is not made, then the plan sponsor will be subject to a nondeductible excise tax equal to 10 percent of the amount of the outstanding liquidity shortfall. A liquidity shortfall payment will no longer be considered outstanding on the earlier of (1) the last day of a later quarter for which the plan does not have a liquidity shortfall or (2) the date on which the liquidity shortfall for a later quarter is timely paid. If the liquidity shortfall remains outstanding after four quarters, the excise tax increases to 100 percent.

Description of Amendment

The amendment would give the Secretary authority to waive all or part of the excise tax imposed for a failure to make a liquidity shortfall payment if the plan sponsor establishes to the satisfaction of the Secretary that the liquidity shortfall was due to reasonable cause and not willful neglect and reasonable steps have been taken to remedy such shortfall.

Effective date.--The amendment would be effective as if included in GATT.

D. Other Provisions

1. Tax-exempt entities owning S corporation stock (sec. 1316 of the bill)

Present Law

A small business corporation may elect to be treated as an S corporation. A "small business corporation" is defined as a domestic corporation which is not an ineligible corporation and which does not have (1) more than 35 shareholders, (2) as a shareholder, a person (other than certain trusts or estates) who is not an individual, (3) a nonresident alien as a shareholder, and (4) more than one class of stock.

Description of Amendment

The Finance Committee bill permits qualified plans and organizations exempt from tax under section 501(c)(3) to be shareholders of an S corporation. The amendment would eliminate the provision in the Finance Committee bill that provides that, if a qualified tax-exempt shareholder has gain on the sale of the stock in a C corporation that once was an S corporation while held by the shareholder, the tax-exempt shareholder must treat as unrelated business taxable income the amount of gain that the shareholder would have recognized had it sold the stock for its fair market value as of the last day of the corporation's last taxable year as an S corporation.

2. Employee housing for certain medical research institutions

Present Law

Under Code section 119(d), employees of an educational institution do not have to include in income the fair market value of campus housing as long as the rent is at least five percent of the appraised value of the housing. If the rent is less than the five-percent safe harbor, there is inclusion into income to the extent that the rent that was charged falls short of the lesser of five percent of the appraised value or the average of rents paid by individuals (other than employees or students of the educational institution) for similar lodging provided by the institution.

Description of Amendment

The amendment would allow certain medical research institutions (“academic health centers”) that engage in basic and clinical research, have a regular faculty and teach a curriculum in basic and clinical research to students in attendance at the institution to be treated as an “educational institution” for purposes of Code section 119(d).

Effective date.--The amendment would be effective for taxable years beginning after December 31, 1995.

II. REVENUE OFFSETS

A. Extension and Phaseout of Excise Tax on Luxury Automobiles (sec. 1604 of the bill)

Present Law

Present law imposes an excise tax on the sale of automobiles whose price exceeds a designated threshold, currently \$34,000. The excise tax is imposed at a rate of 10-percent on the excess of the sales price above the designated threshold. The \$34,000 threshold is indexed for inflation.

The tax generally applies only to the first retail sale after manufacture, production, or importation of an automobile. It does not apply to subsequent sales of taxable automobiles.

The tax applies to sales before January 1, 2000.

Description of Amendment

The reported bill extends and phases out the luxury tax on automobiles (sec. 1604). The tax rate is reduced by one percentage point per year beginning in 1996. The tax rate for sales (on or after July 1) in 1996 is 9 percent. The tax rate for sales in 1997 is 8 percent. The tax rate for sales in 1998 is 7 percent. The tax rate for sales in 1999 is 6 percent. The tax rate for sales in 2000 is 5 percent. The tax rate for sales in 2001 is 4 percent. The tax rate for sales in 2002 is 3 percent. The tax will expire after December 31, 2002.

The amendment would modify the effective date of the bill's provision to sales on or after the date of enactment plus seven days. Thus, the 9-percent tax rate applicable for 1996 would apply to sales on or after the date of enactment plus seven days.

Effective date.--The provision is effective for sales on or after date of enactment plus seven days.

B. Extension of Airport and Airway Trust Fund Excise Taxes (sec. 1607 of the bill)

Present Law

Before January 1, 1996, five separate excise taxes were imposed to fund the Federal Airport and Airway Trust Fund program. These aviation excise taxes were --

- (1) a 10-percent tax on domestic passenger tickets;

- (2) a 6.25-percent tax on domestic freight waybills;
- (3) a \$6-per-person tax on international air departures;
- (4) a 17.5-cents-per-gallon tax on jet fuel used in noncommercial aviation; and
- (5) a 15-cents-per-gallon tax on gasoline used in noncommercial aviation.²⁰

Current Airport and Airway Trust Fund authorizations and expenditure authority extend through September 30, 1996.

Description of Amendment

The Finance Committee reported bill reinstates the Airport and Airway Trust Fund excise taxes for the period beginning seven days after the date of enactment through December 31, 1996. The passenger and freight taxes do not apply to any amount paid before that date, even if for transportation occurring during the reinstatement period.

The amendment would extend the Airport and Airway Trust Fund excise taxes through April 15, 1997.

Effective date.--Same as in the reported bill.

C. Allow Conversion of Scholarship Funding Corporation to Taxable Corporation

Present Law

Qualified scholarship funding corporations are nonprofit corporations established and operated exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965 (sec. 150(d)). In addition, a qualified scholarship funding corporation must be required by its corporate charter and bylaws, or under State law, to devote any income (after payment of expenses, debt service and the creation of reserves for the same) to the purchase of additional student loan notes or to pay over any income to the United States.

In general, State and local government bonds issued to finance private loans (e.g., student loans) are taxable private activity bonds. However, interest on qualified student loan bonds is tax-exempt. Qualified scholarship funding corporations are eligible issuers of qualified student loan bonds.

The Internal Revenue Code restricts the direct and indirect investment of bond proceeds in higher yielding investments and requires that profits on investments that are unrelated to the government purpose for which the bonds are issued be rebated to the

²⁰ 14 cents per gallon of this tax continues to be imposed, with the revenues going to the Highway Trust Fund in the meantime.

United States. Special allowance payments (SAP) made by the Department of Education are treated as interest on notes and, therefore, are permitted arbitrage that need not be rebated to the United States.

Generally, a private foundation and disqualified persons may, in the aggregate, own 20 percent of the voting stock of a functionally unrelated corporation.

Description of Amendment

In general.--The amendment would provide that a nonprofit student loan funding corporation may elect to cease its status as a qualified scholarship funding corporation. If the corporation meets the requirements outlined below, such an election would not cause any bond outstanding as of the date of the issuer's election and any bond issued to refund such a bond to fail to be a qualified student loan bond. Once made, an election could be revoked only with the consent of the Secretary of Treasury. After making the election, the issuer would not be authorized to issue any new bonds.

Requirements.--First, upon making the election, the issuer would be required to transfer all of the student loan notes to another, taxable, corporation in exchange for senior stock of such corporation within a reasonable period of time after the election is made. Immediately after the transfer, the issuer, and any other issuer who made the election, would be required to hold all of the senior stock of the corporation. Senior stock is stock whose rights to dividends, liquidation or redemption rights are not inferior to those of any other class of stock and that (1) participates pro rata and fully in the equity value of any other common stock of the corporation, (2) has the right to payments receivable in liquidation prior to any other stock in the corporation, (3) upon liquidation or redemption, has a fixed right to receive the greater of (a) the fair market value of the stock at the date of liquidation or redemption or (b) the net fair market value of all assets transferred to the corporation by the issuer, and (4) has a right to require its redemption by a date which is not later than 10 years after the date that the election is made.

Second, the transferee corporation would be required to assume or otherwise provide for the payment of all the qualified scholarship funding bond indebtedness of the issuer within a reasonable period after the election.

Third, immediately after the transfer, the issuer (i.e., the nonprofit student loan funding corporation) would be required to become a charitable organization (described in section 501(c)(3) that is exempt from tax under section 501(a)), at least 80 percent of the members of its board of directors must be independent members, and it must hold all of the senior stock of the corporation.

Excess business holdings.--For purposes of the excess business holding restrictions imposed on a private foundation, the charity would not be required to divest its ownership

in a corporation most of whose assets are student loan notes incurred under the Higher Education Act of 1965.

Effective date.--The amendment would be effective on the date of enactment.

**D. Apply Mathematical or Clerical Error Procedures
for Dependency Exemptions and Filing Status
when Correct Taxpayer Identification Numbers are Not Provided**

Present Law

In general

Individuals who claim personal exemptions for dependents must include on their tax return the name and taxpayer identification number (TIN) of each dependent. For returns filed with respect to tax year 1996, individuals must provide a TIN for all dependents born on or before November 30, 1996. For returns filed with respect to tax year 1997 and all subsequent years, individuals must provide TINs for all dependents, regardless of their age. An individual's TIN is generally that individual's social security number.

If the individual fails to provide a correct TIN for a dependent, the Internal Revenue Service may impose a \$50 penalty.

Mathematical or clerical errors

The IRS may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and a period of 60 days to request that the IRS abate its assessment. The IRS may not proceed to collect the amount of the assessment until the taxpayer has agreed to it or has allowed the 60-day period for objecting to expire. If the taxpayer files a request for abatement of the assessment specified in the notice, the IRS must abate the assessment. Any reassessment of the abated amount is subject to the ordinary deficiency procedures. The request for abatement of the assessment is the only procedure a taxpayer may use prior to paying the assessed amount in order to contest an assessment arising out of a mathematical or clerical error. Once the assessment is satisfied, however, the taxpayer may file a claim for refund if he or she believes the assessment was made in error.

Description of Amendment

If an individual fails to provide a correct TIN for a dependent, the IRS would be authorized to deny the dependency exemption. Such a change would also have indirect consequences for other tax benefits currently conditioned on being able to claim a dependency exemption (e.g., head of household filing status and the dependent care credit). In addition, the failure to provide a correct TIN for a dependent would be treated as a mathematical or clerical error and thus any notification that the taxpayer owes additional tax because of that failure would not be treated as a notice of deficiency.

Effective date.--The amendment would be effective for tax returns for which the due date (without regard to extensions) is 30 days or more after the date of enactment. For taxable years beginning in 1995, no requirement to obtain a TIN would apply in the case of dependents born after October 31, 1995. For taxable years beginning in 1996, no requirement to obtain a TIN would apply in the case of dependents born after November 30, 1996.

E. Revision of Expatriation Tax Rules (secs. 1631-1633 of the bill)

Present Law

Individuals who relinquish U.S. citizenship with a principal purpose of avoiding U.S. taxes are subject to special tax provisions for 10 years after expatriation. The determination of who is a U.S. citizen for tax purposes, and when such citizenship is lost, is governed by the provisions of the Immigration and Nationality Act, 8 U.S.C. section 1401, et. seq.

An individual who relinquishes his U.S. citizenship with a principal purpose of avoiding U.S. taxes is subject to tax on his or her U.S. source income at the rates applicable to U.S. citizens, rather than the rates applicable to other non-resident aliens, for 10 years after expatriation. In addition, the scope of items treated as U.S. source income for this purpose is broader than those items generally considered to be U.S. source income. For example, gains on the sale of personal property located in the United States and gains on the sale or exchange of stock or securities issued by U.S. persons are treated as U.S. source income. This alternative method of income taxation applies only if it results in a higher U.S. tax liability.

Rules applicable in the estate and gift tax contexts expand the categories of items that are subject to the gift and estate taxes in the case of a U.S. citizen who relinquished citizenship with a principal purpose of avoiding U.S. taxes within the 10-year period ending on the date of the transfer. For example, U.S. property held through a foreign corporation controlled by such individual and related persons is included in his or her estate and gifts of U.S.-situs intangible property by such individual are subject to the gift tax.

Description of Amendment

Sections 1631-1633 of the bill, as reported by the Senate Finance Committee, replace the present-law expatriation income tax rules with rules that generally subject certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who relinquish their U.S. residency to tax on the net unrealized gain in their property as if such property were sold for fair market value on the expatriation date and also impose information reporting obligations on such individuals. The amendment would modify the present-law rules regarding the application of the estate and gift taxes in the case of a U.S. citizen who relinquished citizenship with a principal purpose of avoiding U.S. taxes within the 10-year period ending on the date of death or transfer, respectively. The amendment would extend such rules to apply not only to U.S. citizens who relinquish citizenship but also to long-term U.S. residents who relinquish their U.S. residency. Moreover, for purposes of these estate and gift tax rules, an individual would be treated as having relinquished U.S. citizenship or U.S. residency for a principal purpose of avoiding U.S. taxes (and therefore would be subject to the expanded reach of the expatriation estate and gift taxes) if such individual is a "covered expatriate" within the meaning of the expatriation income tax rules as amended by the bill. The amendment would provide a credit against the U.S. estate or gift tax imposed under these rules for any foreign gift, estate or similar taxes paid with respect to the items subject to such taxation. This credit would be available only against the tax imposed solely as a result of the expatriation estate and gift tax provisions, and would not be available to be used to offset any other U.S. tax liability. These modifications are not intended to apply to the extent the application would be contrary to any treaty obligation of the United States.

Effective date.-- The amendment would be effective for individuals who relinquish U.S. citizenship or U.S. residency on or after February 6, 1995.