DESCRIPTION OF H.R. 3648 AS INTRODUCED IN THE HOUSE OF REPRESENTATIVES

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
on September 26, 2007

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on September 26, 2007, of H.R. 3648. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's Mark ("H.R. 3648, as introduced in the House of Representatives").

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 3648 as Introduced in the House of Representatives* (JCX-86-07), September 25, 2007. This document can also be found on our website at www.house.gov/jct.

A. Exclude Discharges of Acquisition Indebtedness on Principal Residences from Gross Income

Present Law

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108). In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities immediately after the discharge (sec. 1017).

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

For example, assume a taxpayer who is not in bankruptcy and is not insolvent owns a principal residence subject to a $200,000 mortgage debt. If the creditor forecloses and the home is sold for $180,000 in satisfaction of the debt, the debtor has $20,000 income from the discharge of indebtedness which is includible in gross income. Likewise, if the creditor restructures the loan and reduces the principal amount to $180,000, the debtor has $20,000 includible in gross income.

Description of Proposal

The proposal excludes from the gross income of a taxpayer any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B) without regard to any dollar limitation) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such debt to the extent the amount of the refinancing does not exceed the amount of the refinanced indebtedness. For these purposes the term "principal residence" has the same meaning as under section 121 of the Code.

The basis of the individual's principal residence is reduced by the amount excluded from income under the proposal.

Under the proposal, the exclusion does not apply to a taxpayer in a Title 11 case; instead the present-law exclusion applies. In the case of an insolvent taxpayer not in a Title 11 case, the exclusion under the proposal applies unless the taxpayer elects to have the present-law exclusion apply instead.

Under the proposal, the exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender.

Effective Date

The proposal is effective for discharges of indebtedness on or after January 1, 2007.

B. Extend the Deduction for Private Mortgage Insurance

Present Law

In general

Present law provides that qualified residence interest is deductible notwithstanding the general rule that personal interest is nondeductible (sec. 163(h)).

Acquisition indebtedness and home equity indebtedness

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is $100,000. The maximum amount of acquisition indebtedness is $1 million. Acquisition indebtedness means debt that is incurred in acquiring constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

Private mortgage insurance

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of married individual filing a separate return).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration, and private mortgage insurance (defined in section 2 of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Administration).

The provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates for any amount paid or accrued after December 31, 2007, or properly allocable to any period after that date.

Reporting rules apply under the provision.

Description of Proposal

The proposal extends the deduction for private mortgage insurance to amounts paid or accrued after December 31, 2007, but only with respect to contracts entered into after December 31, 2006, and prior to January 1, 2015.

Effective Date

The proposal applies to contracts entered into after December 31, 2006, and before January 1, 2015, with respect to amounts paid or accrued after December 31, 2007.

C. Alternative Tests for Qualifying as Cooperative Housing Corporation

Present Law

Under present law, a tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid or accrued to the cooperative to the extent those amounts represent the tenant-stockholder's proportionate share of (1) real estate taxes allowable as a deduction to the cooperative which are paid or incurred by the cooperative on the cooperative's land or buildings and (2) interest allowable as a deduction to the cooperative that is paid or incurred by the cooperative on its indebtedness contracted in the acquisition of the cooperative's land or in the acquisition, construction, alteration, rehabilitation, or maintenance of the cooperative's buildings.

A cooperative housing corporation generally is a corporation (1) that has one class of stock, (2) each of the stockholders of which is entitled, solely by reason of ownership of stock in the corporation, to occupy a dwelling owned or leased by the cooperative, (3) no stockholder of which is entitled to receive any distribution not out of earnings and profits of the cooperative, except on complete or partial liquidation of the cooperative, and (4) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest are paid or accrued is derived from tenant-stockholders.

Description of Proposal

Under the proposal, the fourth requirement listed above is amended to provide that the requirement is met if, for the taxable year in which the taxes and interest are paid or accrued, the corporation meets one of three requirements--(1) 80 percent or more of the corporation's gross income for that taxable year is derived from tenant-stockholders (the present law requirement); (2) at all times during that table year 80 percent or more of the total square footage of the corporation's property is used or available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use; or (3) 90 percent or more of the expenditures of the corporation paid or incurred during that taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of tenant-stockholders.

Effective Date

The proposal applies to taxable years ending after the date of enactment.

D. Exclusion of Gain on Sale of a Principal Residence Not to Apply to Nonqualified Use

Present Law

In general

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

Present law also contains an election relating to members of the uniformed services, the Foreign Service, and certain employees of the intelligence community.[2] If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to 10 years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty. For these purposes, qualified official extended duty is any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. The election may be made with respect to only one property for a suspension period.

The exclusion does not apply to gain to the extent the gain is attributable to depreciation allowable with respect to the rental or business use of a principal residence for periods after May 6, 1997.

Description of Proposal

Under the proposal, gain from the sale or exchange of a principal residence allocated to periods of nonqualified use is not excluded from gross income. The amount of gain allocated to periods of nonqualified use is the amount of gain multiplied by a fraction the numerator of which is the aggregate periods of nonqualified use during the period the property was owned by the taxpayer and the denominator of which is the period the taxpayer owned the property.

A period of nonqualified use means any period (not including any period before January 1, 2008) during which the property is not used by the taxpayer or the taxpayer's spouse or former spouse as a principal residence. For purposes of determining periods of nonqualified use, any period after the last date the property is used as the principal residence of the taxpayer or spouse, and any period (not to exceed two years) that the taxpayer is temporarily absent by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen

[2] The provision relating to employees of the intelligence community is effective for sales and exchanges before January 1, 2011.

circumstances, are not taken into account. The present-law election for the uniformed services, Foreign Service and employees of the intelligence community is unchanged.

If any gain is attributable to post-May 6, 1997, depreciation, the exclusion does not apply to that amount of gain, as under present law, and that gain is not taken into account in determining the amount of gain allocated to nonqualified use.

The provisions of this proposal may be illustrated by the following examples:

Example 1.–Assume that an individual buys a property on January 1, 2008, for $400,000, and uses it as rental property for two years claiming $20,000 of depreciation deductions. On January 1, 2010, the taxpayer converts the property to his principal residence. On January 1, 2012, the taxpayer moves out, and the taxpayer sells the property for $700,000 on January 1, 2013. As under present law, $20,000 gain attributable to the depreciation deductions is included in income. Of the remaining $300,000 gain, 40% of the gain (2 years divided by 5 years), or $120,000, is allocated to nonqualified use and is not eligible for the exclusion. Since the remaining gain of $180,000 is less than the maximum gain of $250,000 that may be excluded, gain of $180,000 is excluded from gross income.

Example 2.–Assume that an individual buys a principal residence on January 1, 2008, for $400,000, moves out on January 1, 2018, and on December 1, 2020 (more that two years after it was last used as the principal residence) sells the property for $600,000. The entire $200,000 gain is excluded from gross income, as under present law.

Effective Date

The proposal is effective for sales and exchanges after December 31, 2007.

E. Modifications to Corporate Estimated Tax Payments

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

Under present law, in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 114.75 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Description of Proposal

The proposal increases the percentage from 114.75 percent to 116.50 percent.

Effective Date

The proposal is effective on the date of enactment.