4

[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS

(S. 169, S. 532, S. 791, S. 721, S. 979, AND S. 1382)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON JUNE 26, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

JUNE 24, 1981

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1981

80-538 O

JCS-32-81

CONTENTS

INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on June 26, 1981, by the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance.

There are six bills scheduled for the hearing: S. 169 (relating to tax-exempt financing for pollution control and solid waste disposal facilities, and expensing of amounts paid in connection with the construction of pollution control facilities), S. 532 and S. 791 (relating to the unemployment tax status of certain fishing boat services), S. 721 (relating to the imposition of State income taxes on income derived from services performed at the Portsmouth Naval Shipyard by individuals who are not residents or domiciliaries of the State of Maine), and S. 979 and S. 1382 (relating to the treatment of interest on obligations of certain volunteer fire departments).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, issues, explanation of the provisions of the bills, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 169—Senators Heinz, Randolph, and Glenn

Tax Treatment of Industrial Development Bonds for Pollution Control or Waste Disposal Facilities and Expensing of Pollution Control Facilities

a. Title I. Industrial development bonds for pollution control or waste disposal facilities

Present law allows tax-exempt industrial development bonds to be issued for solid waste disposal facilities and for air or water pollution control facilities (Code sec. 103(b)(4)). Treasury Regulations restrict the exemption to bonds which are issued to finance pollution control facilities that remove, alter, dispose, or store a pollutant. Tax exemption is not available with respect to bonds which are issued to finance a facility which prevents the creation of a pollutant. Furthermore, Treasury Regulations take the position that pollution control does not include facilities used in the handling or disposal of hazardous waste.

The bill would expand the type of facilities for which tax-exempt industrial development bonds could be issued to include facilities which prevent the creation of a pollutant. In general, a facility would be considered a pollution control facility if it were certified by a Federal or State authority as meeting or furthering pollution control requirements. The bill contains special rules to limit the amount of eligible costs to specified dollar amounts in the case of new plants. The bill also would provide that tax-exempt industrial development bonds could be issued for hazardous waste and solid waste disposal facilities that have no significant purpose other than to comply with the Solid Waste Disposal Act.

The bill would apply to obilgations issued after the date of enactment.

b. Title II. Expensing of pollution control facilities

Present law allows special 5-year amortization of pollution control facilities (Code sec. 169). Pollution control facilities for this purpose are facilities, used in connection with property placed in operation prior to January 1, 1976, which control, remove, alter, dispose, store, or prevent the creation of pollutants.

The bill would allow immediate expensing of certified pollution control facilities. Furthermore, there would be no recapture of the amount expensed upon the disposition of a certified pollution control facility.

The bill would apply to amounts paid or incurred after December 31, 1980.

2. S. 532—Senator Heflin

and

S. 791—Senators Mitchell, Mathias, and Heflin

Unemployment Tax Status of Certain Fishing Boat Services

Under present law, certain crew members of fishing boats are treated as self-employed individuals rather than as employees for purposes of the Federal Insurance Contributions Act (FICA) and income tax withholding. However, services which are not subject to FICA taxes are not exempt for purposes of the Federal Unemployment Tax Act (FUTA) if the services are related to catching halibut or salmon for commercial purposes or if the services are performed on a vessel of more than ten net tons.

The bills would exclude from coverage, for purposes of FUTA, those services of fishing boat crew members which currently are excluded for purposes of FICA and income tax withholding.

The bills would apply to services performed in taxable years beginning after December 31, 1980.

3. S. 721—Senator Humphrey

Imposition of Tax by a State on Income Derived From Services Performed at the Portsmouth Naval Shipyard by Individuals Who Are Not Residents or Domiciliaries of Maine

Under present law, States in which Federal areas are located may impose State income tax on the income derived from services performed in such areas, regardless of the residence or domicile of the individual performing such services.

The bill would prohibit Maine from imposing State income tax on the income derived from services performed in the Portsmouth Naval Shipyard unless the individual performing such services is a resident or domiciliary of Maine during the period services were performed.

The bill would benefit individuals who work at the Portsmouth Naval Shipyard who are not residents or domiciliaries of the State of Maine.

The bill would apply with respect to services performed after December 31, 1980.

4. S. 979—Senators Lugar and Quayle

and

S. 1382—Senator D'Amato

Tax Exemption for Interest on Obligations of Certain Volunteer Fire Departments

In general, present law excludes from gross income interest on obligations of a State or of its political subdivisions (Code sec. 103 (a)(1)). A political subdivision generally includes any division of a

State or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit.

The bills would treat an obligation of a volunteer fire department as an obligation of a political subdivision of a State if certain conditions are met. In general, these conditions would be as follows: (1) the volunteer fire department is the sole organization providing firefighting services in a particular area; (2) the volunteer fire department is required by the political subdivision, by agreement or otherwise, to provide firefighting services; (3) the volunteer fire department must receive more than one-half of its funds from the political subdivisions; and (4) the volunteer fire department must make no charge for its firefighting services.

The originally intended beneficiaries of S. 979 were the Wayne Township Volunteer Fire Department of Marion County, Indiana, and holders of obligations issued by that department. However, each bill would apply to obligations of any volunteer fire department in the country that satisfies the conditions of the bills.

The bills would apply to obligations issued after December 31, 1968.

II. DESCRIPTION OF BILLS

1. S. 169—Senators Heinz, Randolph, and Glenn

Tax Treatment of Industrial Development Bonds for Pollution Control or Waste Disposal Facilities and Expensing of Pollution Control Facilities

a. Industrial development bonds for pollution control or waste disposal facilities (Title I of the bill)

Present law

Industrial development bonds—In general

In general, interest on State and local government bonds is exempt from Federal income tax (Code sec. 103(a)). However, with certain exceptions, this exemption does not apply to interest on State and local government issues of "industrial development bonds." An obligation constitutes an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a State or local government or tax-exempt organization, and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property, or borrowed money, used in a trade or business (Code sec. 103(b)(2)).

Under one of the exceptions, industrial development bonds qualify for tax exemption if substantially all of the proceeds of the bonds are used to provide exempt activity facilities. Such facilities include solid waste disposal facilities (Code sec. 103(b)(4)(E)) and air or water pollution control facilities (Code sec. 103(b)(4)(F)).

Solid waste disposal facilities

Under Treasury Regulations, a solid waste disposal facility is defined as any property, or portion thereof, used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste (Treas. Reg. sec. 1.103-8(f)(2)). A facility for collection, storage, or disposal of liquid or gaseous waste does not qualify as a solid waste disposal facility unless functionally related and subordinate to a solid waste disposal facility. The Treasury Regulations provide that "solid waste" has the same meaning for purposes of the provisions relating to tax-exempt industrial development bonds as it has for purposes of the Solid Waste Disposal Act (prior to the amendment of that Act by

P.L. 94–580).[1] However, material will not qualify as solid waste unless, on the date of issue of the obligations issued to provide the solid waste disposal facility, the material is useless, unused, unwanted, or discarded solid material that has no market or other value at the place where it is located. A facility that disposes of solid waste by reconstituting, converting, or otherwise recycling it into material that is not waste qualifies as a solid waste disposal facility if solid waste constitutes at least 65 percent, by weight or volume, of the total materials introduced into the recycling process (Treas. Reg. sec. 1.103–8 (f) (2) (ii) (c)).

Pursuant to Temporary Treasury Regulations, if property has both a solid waste disposal function and a function other than solid waste disposal, then only the portion of the cost of the property allocable to the solid waste disposal function may be taken into account as an expenditure to provide solid waste disposal facilities (Temp. Treas. Reg. sec. 17.1). These regulations provide that a facility that otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material or heat that has utility or value is recovered or results from the disposal process. Moreover, if materials or heat are recovered, the waste disposal function includes the processing of such materials or heat that occurs in order to put them into the form in which the materials or heat are in fact sold or used. However, the waste disposal function does not include further processing that converts the materials or heat into other products. Based upon these regulations, the Internal Revenue Service held, in Revenue Ruling 76–222 (1976–1 C.B. 26), that garbage which is recycled into salvageable metal and combustible materials to be used in an adjacent public utility plant for fuel is solid waste. However, the portion of the facility that transported the combustibles to the public utility did not qualify as part of the exempt solid waste facility because, at that point, the combustibles had been converted into a useful and valuable form, in which they would be sold, and were no longer waste.

Present law does not contain a specific tax exemption for industrial development bonds the proceeds of which are used to provide hazardous waste disposal facilities.

---

[1] The regulations define solid waste as garbage, refuse, and other discarded solid materials, including solid waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but not including solids or dissolved material in domestic sewage or other significant pollutants in water resources such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows, or other common water pollutants (Treas. Reg. sec. 1.103–8(f) (2) (ii) (b)).

The Solid Waste Disposal Act currently defines solid waste as any garbage, refuse, sludge from a waste treatment plant, water supply treatment plant, or air pollution control facility, and other discarded material, including solid, liquid, semisolid, or contained gaseous material resulting from industrial, commercial, mining, and agricultural operations, and from community activities, but not including solid or dissolved material in domestic sewage, or solid or dissolved materials in irrigation return flows or industrial discharges which are point sources subject to permits under section 1342 of Title 33 (Federal Water Pollution Act), or source, special nuclear, or byproduct material as defined by the Atomic Energy Act of 1954 (42 U.S.C. sec. 6903(27)).

Air or water pollution control facilities

Treasury Regulations provide that in order for property to qualify as a pollution control facility (1) it must be land or depreciable property and (2) a Federal, State, or local agency must certify that the facility is in furtherance of the purpose of abating or controlling atmospheric pollutants or contaminants or water pollution or the facility must be designed to meet or exceed applicable Federal, State, and local requirements for the control of atmospheric contaminants or water pollution in effect at the time the obligations, the proceeds of which are to be used to provide such facilities, are issued (Treas. Reg. sec. 1.103–8(g)(2)(i)).

In 1975, the Treasury Department issued proposed regulations in order to provide additional guidance concerning what facilities constitute pollution control facilities. In general, these proposed regulations consider property to be a pollution control facility if it is a discrete unit that cannot be reduced further in size without losing one of its characteristics which is used, in whole or in part, to abate or control water or atmospheric pollution or contaminants, waste, or heat. Pollutants include only material or heat in such a state or form that its discharge or release would result in water or atmospheric pollution or contamination.

The proposed regulations describe several types of property that do not qualify as pollution control facilities (Prop. Treas. Reg. secs. 1.103–8(g)(2) (ii), (iii) and (iv)). These include property that avoids the creation of pollutants and property that is used solely for the processing or manufacturing of material or heat after such material or heat is no longer a pollutant. Moreover, property, is not considered to be a pollution control facility to the extent that it treats or processes a material in such a manner as to prevent the discharge or release of pollutants when such material is subsequently used. Furthermore, the proposed regulations take the position that property is not used for the control of pollution to the extent that it (1) is designed to prevent the release of pollutants in a major accident; (2) prevents the release of materials or heat which would endanger the employees of the trade or business in which such property is used; (3) is used to control materials or heat that traditionally have been controlled because their release would constitute a nuisance; (4) controls the release of hazardous materials or heat that would cause an immediate risk of substantial damage or injury to property or persons; or (5) controls materials or heat in essentially the same manner as the user of such property has previously controlled such materials or heat as a customary practice for reasons other than compliance with pollution control requirements.

If a pollution control facility has a function other than to abate or control water or atmospheric pollution or contamination, then only the incremental cost of the property may be taken into account as an expenditure to provide an air or water pollution control facility. Such incremental cost is the portion of the cost of the property that is allocable to the control of pollution (Prop. Treas. Reg. sec. 1.103–8(g)(3)). The proposed regulations provide detailed rules for valuing any benefits derived from pollution control facilities. In general, if a pollution control facility results in an economic benefit, the portion of the cost of the property allocable to the control of pollution is the cost of the property reduced by the amount, if any, determined by multiplying the cost by a fraction the numerator of which is the present value of all estimated economic benefits to be realized over the useful life of the property and the denominator of which is the sum of the present value of payments (other than interest) necessary to acquire ownership of the property plus the present value of all estimated expenses to be paid or incurred in operating or maintaining the property. Present value is computed by use of a discount rate of 12½ percent.

Issues

Title I of the bill raises several issues. These issues include: (1) Whether tax-exempt financing should be available for pollution control facilities that prevent the creation of pollution and, if so, how pollution control facilities could be differentiated from manufacturing facilities; (2) whether there should be an expenditure ceiling on the amount of pollution control facilities that can qualify for tax-exempt financing in the case of new plants and, if so, what limitations would be appropriate; and (3) whether tax-exempt bonds should be allowed for facilities that handle hazardous waste because those facilities are required by the Solid Waste Disposal Act even though the facilities would have been required notwithstanding that Act because they are part of the manufacturing process or would be required under State laws governing nuisances.

Explanation of provision

Air or water pollution control facilities

Title I of the bill would revise the requirements relating to the tax exemption for industrial development bonds that are issued to provide air or water pollution control facilities. Under the bill, an air or water pollution control facility would be land or depreciable property that meets the following requirements:

(1) It is acquired, constructed, reconstructed, or erected to abate or control water or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat;

(2) It must be certified by a Federal or State certifying authority as meeting or furthering Federal or State requirements for abatement or control of water or atmospheric pollution or contamination; [2] and

(3) All or a portion of the expenditures for the acquisition, construction, reconstruction, or erection of the property would not be made except for the purpose of abating, controlling, or preventing pollution.

---

[2] A Federal certifying authority is, in the case of water pollution, the Secretary of the Interior and, in the case of air pollution, the Secretary of Health and Human Services (Code sec. 169(d)(3)). A State certifying authority is, in the case of water pollution, the State water pollution control agency as defined in section 13(a) of the Federal Water Pollution Control Act and, in the case of air pollution, the air pollution control agency as defined in section 302(b) of the Clean Air Act. A State certifying authority also may be any interstate agency authorized to act in place of a certifying authority of the State (Code sec. 169(d)(2)).

The bill would limit the amount of tax-exempt financing available for pollution control facilities to the extent that portions of the cost of a certified pollution control facility are recoverable in the form of an economic benefit. This would be accomplished by limiting the tax exemption to the cost of acquiring, constructing, reconstructing, or erecting the pollution control facility after reducing that cost by the net profit which may reasonably be expected to be derived through the recovery of wastes or otherwise in the operation of the facility over its actual useful life. For purposes of this calculation, "net profit" would be the present value of benefits (using a discount rate of 12½ percent) to be derived from that portion of the cost which is properly attributable to the purpose of increasing the output or capacity, extending the useful life, or reducing the total operating costs of the plant or other property (or any unit thereof) in connection with which the facility is to be operated, reduced by the sum of (1) the total cost incurred to acquire, construct, reconstruct, or erect the property (reduced by its estimated salvage value) and (2) the present value (using a 12½ percent discount rate) of all expenses reasonably expected to be incurred in the operation and maintenance of the property, including utility and labor costs, Federal, State, and local income taxes, the cost of insurance, and interest expense.

The bill also would limit the amount of tax-exempt financing for pollution control facilities to be installed at any new manufacturing or processing plant. In the case of a new plant, the amount of tax-exempt financing for pollution control facilities, reduced to the extent of any net economic benefit, would be limited to: 30 percent of the first $100 million of capital expenditures for the entire plant or site, 25 percent of the second $100 million, 20 percent of the third $100 million, and 15 percent of expenditures in excess of $300 million. (This would amount to $105 million in the case of a new plant costing $500 million.) Capital expenditures subject to this limitation would be those made within 3 years before and 3 years after the date on which the bonds are issued. For purposes of this limitation, a new plant would be any plant, or identifiable part thereof, or other location that is, or could be, a source of pollution, which is placed in service within the 6-year period beginning 3 years before the date of any issue for the facility and ending 3 years after the date of issuance. A 35-percent expansion of an existing plant or a conversion affecting 35 percent of the output of a plant would cause an existing plant to be treated as a new plant.

Solid waste disposal facilities

Title I of the bill also would revise the requirements relating to the tax exemption for industrial development bonds issued to provide financing for solid waste disposal facilities, and would provide tax exemption for industrial development bonds issued to provide financing for hazardous waste [3] disposal facilities.

[3] The Solid Waste Disposal Act defines hazardous waste as a solid waste, or combination of solid wastes, which because of its quantity, concentration, or physical, chemical, or infectious characteristics may: (1) cause, or significantly contribute to, an increase in serious irreversible, or incapacitating reversible, illness; or (2) pose a substantial present, or potential, hazard to human health or the environment when improperly treated, stored, transported, or disposed of, or otherwise managed (42 U.S.C. sec. 6903(5)). The definition of solid waste is at f. n. 1, supra.

Hazardous or solid waste disposal facilities would be land or depreciable property which is acquired, constructed, reconstructed, or erected for no significant purpose other than to comply with hazardous or solid waste management requirements imposed by the Solid Waste Disposal Act. Hazardous waste management is the systematic control of the collection, source separation, storage, transportation, processing, treatment, recovery, and disposal of hazardous wastes.[4] Solid waste management is the systematic administration of activities which provide for the collection, source separation, storage, transportation, transfer, processing, treatment, and disposal of solid waste.[5] The Administrator of the Environmental Protection Agency is responsible for issuing guidelines with respect to hazardous waste and solid waste management.

The bill would make clear that, for purposes of the provisions relating to hazardous waste or solid waste disposal facilities, any reference to the Solid Waste Disposal Act means the Solid Waste Disposal Act as amended by the Resource Conservation and Recovery Act of 1976, and as it may be amended from time to time by other Acts.

Effective date

The provisions of Title I of the bill would apply with respect to obligations issued after the date of enactment and with respect to taxable years ending after that date.

---

[4] 42 U.S.C. sec. 6903(7).
[5] 42 U.S.C. sec. 6903(28).

b. Expensing of pollution control facilities (Title II of the bill)

Present law

A taxpayer who installs a certified pollution control facility may elect to amortize the property ratably over a 60-month period (Code sec. 169) and also may be eligible for a 10 percent investment tax credit. If the taxpayer's acquisition of the property is financed with the proceeds from an industrial development bond, the property is eligible for 50 percent of the investment tax credit, i.e., 5 percent.

A certified pollution control facility is a new identifiable treatment facility which is used in connection with property in operation before January 1, 1976, to abate or control water or atmospheric pollution by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat. Certification is required from appropriate Federal and State authorities that the property meets the applicable standards and requirements. In addition, installation of the pollution control facility may not significantly increase the output or capacity, extend the useful life, or reduce the total operating costs of the property (or any unit thereof), or alter the nature of the manufacturing or production process or facility. The Statement of Managers accompanying the Conference Report on the Tax Reform Act of 1976 defined a significant effect on output or costs to mean a change greater than 5 percent.

A new identifiable treatment facility includes only tangible property subject to the allowance for depreciation, which is identifiable as a treatment facility and was completed, or was placed in service as a new facility, after December 31, 1968. An eligible facility does not include a building and its structural components, but a building which is exclusively a treatment facility is eligible for the amortization election.

For a facility with a useful life in excess of 15 years, the basis for amortization is determined as the ratio of 15 to the number of years of useful life of the facility. The useful life is determined as of the first day of the first month for which an amortization deduction is allowable.

Amortization deductions taken for certified pollution control property are subject to recapture under Code sections 1245 and 1250.

Present law imposes an add-on minimum tax on items of tax preference other than the capital gains deduction and adjusted itemized deductions (Code sec. 56). Among the items of preference subject to this tax is the amount by which the deduction allowable under Code section 169 exceeds the depreciation deduction that would otherwise be allowable. The tax applies at a rate of 15 percent on the sum of tax preferences in excess of one-half of regular income taxes paid or, if greater, $10,000.

Legislative background

Section 169 of the Code was enacted as part of the Tax Reform Act of 1969. It was included in that Act in order to provide some additional relief for publicly mandated expenditures in lieu of the investment tax credit that was repealed in the Tax Reform Act of 1969, as of April 18, 1969. Code section 169 was enacted for the period through December 31, 1974, and it was extended for one year through December 31, 1975. The section was made permanent in the Tax Reform Act of 1976, as amended by that Act.

Issues

Title II of the bill presents several issues. Among these are the following:

(1) How would pollution control facilities be differentiated from manufacturing facilities?

(2) Should the capitalizable costs of a certified pollution control facility be expensed or subject to depreciation or amortization but under more favorable terms than comparable equipment not used for pollution control is allowed under present law?

(3) Should accelerated rates of capital writeoff be exempted from classification as a tax preference item subject to the minimum tax?

(4) Should the gain on sale of certified pollution control property continue to be subject to recapture under section 1245 or 1250?

Explanation of provision

Instead of the election to use 60-month amortization for a certified pollution control facility, the bill would allow a taxpayer to elect to expense (instead of charging to capital account) the amounts paid or incurred in connection with the acquisition, construction, or erection of a certified pollution control facility. The taxpayer could terminate this election, at any time, and discontinue the deductions with respect to the remainder of the amounts paid or incurred with respect to the facility. The depreciation deductions allowed under Code section 167 would apply to the remaining amounts.

The proposal would make the expensing deduction available for the costs incurred for installing a certified pollution control facility in a new property or a new plant, as well as in a plant or a property that was in operation before January 1, 1976. This action would repeal the requirement that an eligible facility be placed in a plant that was in existence before January 1, 1976.

The investment tax credit would continue to be available for a pollution control facility, even though it is expensed under this proposal, according to the number of years in its useful life.

The inclusion of amortization for pollution control facilities in excess of straight-line depreciation as a tax preference also would be repealed. The bill does not propose any additions to the list of tax preferences.

In addition, the recapture rules in Code sections 1245 and 1250 would not apply to property that was expressed under the provisions of this bill.

Effective date

The provisions of title II of the bill would apply to amounts paid or incurred after December 31, 1980.

c. Revenue effect

The estimated reductions in calendar year tax liabilities, and in fiscal year budget receipts, for S. 169 are summarized in the following table for 1981–1986:

(Billions of dollars)

	1981	1982	1983	1984	1985	1986
Calendar year liabilities						
Title I	0.0	0.1	0.1	0.2	0.2	0.3
Title II	1.8	1.7	1.6	1.5	1.5	1.5
Total	1.8	1.8	1.7	1.7	1.7	1.8
Fiscal year receipts						
Title I	0.0	0.0	0.1	0.1	0.2	0.2
Title II	0.9	1.7	1.6	1.6	1.5	1.5
Total	0.9	1.7	1.7	1.7	1.7	1.7

Note: It is not known with certainty which additional pollution control facilities would qualify for the preferential tax treatment. The estimates listed above assume that approximately 20 percent of all pollution control expenditures would qualify.

2. S. 532—Senator Heflin

and

S. 791—Senators Mitchell, Mathias, and Heflin

Unemployment Tax Status of Certain Fishing Boat Services

Present law

Under present law (Code sec. 3121(b)(20)), services performed by members of the crew on boats engaged in catching fish or other forms of aquatic animal life are exempt from the tax imposed by the Federal Insurance Contributions Act (FICA) if their remuneration is a share of the boat's catch (or cash proceeds from the sale of a share of the catch) and if the crew of such boat normally is made up of fewer than ten individuals. In the case of a fishing operation involving more than one boat, the exemption applies if the remuneration is a share of the entire fleet's catch or its proceeds, and if the operating crew of each boat in the fleet normally is made up of fewer than ten individuals.

In addition, the remuneration received by those fishing boat crew members whose services are exempt for purposes of FICA is not considered to be "wages" for purposes of income tax withholding (Code sec. 3401(a)(17)) and those individuals are considered to be self-employed for purposes of the Self-Employment Contributions Act (Code sec. 1402(c)(2)(F)). However, the employer of such individuals whose services are exempt for FICA purposes, and whose remuneration is not subject to income tax withholding, is not exempt from tax under the Federal Unemployment Tax Act (FUTA) if the services performed are related to catching halibut or salmon for commercial purposes or if the services are performed on a vessel of more than ten net tons.

Issue

The issue is whether the services of all fishing boat crew members which currently are exempt for purposes of FICA also should be exempt for purposes of FUTA.

Explanation of the bills

The bills would exempt, for purposes of FUTA, the services of fishing boat crew members which currently are exempt for purposes of FICA. Thus, services by members of the crew on boats engaged in catching fish or other forms of aquatic animal life would be exempt for purposes of FUTA if the remuneration for those services is a share of the boat's catch, or of the proceeds of the catch, and if the crew of such boat normally is made up of fewer than ten individuals. In the case of a fishing operation involving more than one boat, services would be exempt for purposes of FUTA if the remuneration for services is a share of the entire fleet's catch or its proceeds, and if the operating crew of each boat in the fleet normally is made up of fewer than ten individuals.

Effective date

The provisions of the bills would apply to services performed by fishing boat crew members in taxable years beginning after December 31, 1980.

Revenue effect

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

Prior Congressional action

An identical bill (S. 1194, 96th Cong.) was the subject of hearings in the Subcommittee on Taxation and Debt Management of the Senate Finance Committee during the 96th Congress (February 29 and March 4, 1980).

During the 95th Congress, the Senate Finance Committee, on July 24, 1978, held a hearing on another identical bill (H.R. 3080, 95th Cong.).

No further action was taken on either of these bills.

3. S. 721—Senator Humphrey

Imposition of Tax by a State on Income Derived From Services Performed at the Portsmouth Naval Shipyard by Individuals Who Are Not Residents or Domiciliaries of Maine

Present law

Under present law, income derived from services rendered, or transactions occurring, in a Federal area located within any State generally is subject to State income tax. Any State or its taxing authority has full jurisdiction to levy and collect such tax in Federal areas within the State to the same extent as in non-Federal areas (4 U.S.C. sec. 106).

Issue

The issue is whether income derived by individuals from services rendered, or transactions occurring, in a Federal area should be subject to income taxes imposed by the State in which the Federal area is located if they are not residents or domiciliaries of such State.

Explanation of the bill

Under the bill, income derived from services performed, or transactions occurring, at the Portsmouth Naval Shipyard by individuals who are neither residents nor domiciliaries of the State of Maine during the period that they performed those services would be exempt from income taxes imposed by the State of Maine.

The bill would benefit individuals who work at the Portsmouth Naval Shipyard who are not residents or domiciliaries of the State of Maine.

Effective date

The provisions of the bill would apply with respect to income received from transactions occurring or services performed after December 31, 1980.

Revenue effect

The bill would result in a small increase in Federal revenues (less than $1 million annually) because of the fact that fewer individuals would be claiming an itemized deduction for State income taxes.

4. S. 979—Senators Lugar and Quayle

and

S. 1382—Senator D'Amato

Tax Exemption for Interest on Obligations of Certain Volunteer Fire Departments

Present law

In general

In general, present law excludes from gross income interest on obligations of a State or of its political subdivisions (Code sec. 103(a)(1)). Under Treasury Regulations, the term "political subdivision" includes any division of a State or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit (Treas. Reg. sec. 1.103-1(b)). Three generally acknowledged sovereign powers of States are the power to tax, the power of eminent domain, and the police power.[1]

Present Treasury Regulations treat obligations issued by or on behalf of any State or local governmental unit by constituted authorities empowered to issue such obligations as the obligations of such a unit (Treas. Reg. sec. 1.103-1(b)). Several requirements must be satisfied in order for an issuer to qualify as a constituted authority of a State or local governmental unit (See Rev. Rul. 57-187, 1957-1 C.B. 65; Rev. Rul. 63-20, 1963-1 C.B. 24; and Prop. Treas. Reg. sec. 1.103-1(c)(2)).[2]

In an early ruling,[3] the Internal Revenue Service ruled that interest received on certificates of indebtedness, known as "fire relief certificates," issued in the State of Minnesota constituted interest on the obligations of a State and, therefore, was not taxable. In another early ruling,[4] the Service held that interest on fire district bonds issued by a political subdivision of a State and assumed by a private corporation (without releasing the municipality from liability) was exempt from taxation.

---

[1] See, e.g., *Estate of Alexander J. Shamberg*, 3 T.C. 131, aff'd 144 F. 2d 998 (2d Cir.), cert. den., 323 U.S. 792 (1944).

[2] In general, the Proposed Regulations provide that these requirements are satisfied if: (1) the authority is specifically authorized pursuant to State law to issue obligations to accomplish public purposes of the unit; (2) the unit controls the governing board of the authority; (3) the unit has either organizational control over the authority or supervisory control over the activities of the authority; (4) any net earnings of the authority (beyond that necessary for retirement of the indebtedness or to implement the public purposes or program of the unit) may not inure to the benefit of any person other than the unit: (5) upon dissolution of the authority, title to all property owned by the authority will vest in the unit; and (6) the authority is created and operated solely to accomplish one or more of the public purposes of the unit specified in the authorization for the unit.

[3] O.D. 30, 1 C.B. 83, declared obsolete, Rev. Rul. 69-31, 1969-1 C.B. 307.

[4] S.M. 2670, III-2 C.B. 80, declared obsolete, Rev. Rul. 69-31, 1969-1 C.B. 307.

The U.S. Tax Court has held that certain volunteer fire departments (in Pennsylvania, West Virginia, Delaware, Maryland, and Kentucky) were not political subdivisions of the States in which they were located and, hence, that interest on their obligations was not exempt from tax under Code section 103(a)(1) (*Seagrave Corporation*, 38 T. C. 247 (1962)). The rationale for this holding was that the volunteer fire departments involved were not created by any special statutes and received no delegation of State power.

Bonds for tax-exempt fire departments

The exclusion for interest on State and local government bonds does not apply, with certain exceptions, to interest on State and local government issues of "industrial development bonds." An obligation constitutes an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a State or local government or an organization which is exempt from tax under Code section 501(c)(3), and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property, or borrowed money, used in a trade or business (Code sec. 103(b)(2)). Thus, an obligation issued by a State or local government the proceeds of which would be used by a volunteer fire department that qualifies for tax exemption under Code section 501(c)(3) would not be an industrial development bond [5] and the interest thereon would be exempt from tax.

Issue

The issue is whether volunteer fire departments which satisfy certain requirements should be treated as political subdivisions and, thus, be permitted to issue obligations the interest on which would be exempt from Federal income tax under Code section 103(a).

Explanation of the bills

Under the bills, an obligation of a volunteer fire department would be treated as an obligation of a political subdivision of a State if the department is a qualified volunteer fire department with respect to an area within the jurisdiction of such political subdivision, and the obligation is issued as part of an issue substantially all the proceeds of which are to be used for the acquisition, construction, reconstruction, or improvement of qualified firefighting property.

To be qualified, the department must be organized and operated to provide firefighting services for persons in an area (within the jurisdiction of a political subdivision of a State) which is not provided with any other firefighting services, and must be required by the political subdivision (by agreement or otherwise) to furnish firefighting services in such area. Furthermore, the fire department must receive more than half of the funds for outfitting its members and providing and maintaining its qualified firefighting property from the political subdivision, and must not charge for its firefighting services.

---

[5] Depending on the facts involved, a volunteer fire department may qualify for exemption as a charitable organization under Code sec. 501(c(3) or as a social welfare organization under Code sec. 501(c)(4), or both. Rev. Rul. 74-361, 1974-2 C.B. 159.

Qualified firefighting property, for which a tax-exempt obligation could be issued, would be depreciable property, and property that is used in the performance of (or in training for the performance of) firefighting or ambulance services, or property that is used to house such property.

The bills also would provide that failure of an obligation to meet the requirements of the bills is not to be construed as meaning that interest on such an obligation necessarily is taxable.

The originally intended beneficiaries of S. 979 were the Wayne Township Volunteer Fire Department of Marion County, Indiana, and the holders of obligations issued by that Department.

However, each bill would apply to obligations of any volunteer fire department in the country that satisfies requirements of the bills.

Effective date

The provisions of each bill would apply to obligation issued after December 31, 1968.

Revenue effect

Originally, S. 979 was intended to benefit Wayne Township Volunteer Fire Department of Marion County, Indiana and the holders of bonds issued by the Department. If the definition of a qualified volunteer fire department limits the issuance of tax-exempt bonds to the abovementioned department, the reduction in budget receipts, based upon the amount of interest payable on the known outstanding obligations of the Department, is estimated to be $21,360. However, as mentioned above, other volunteer fire departments could meet the requirements of the bills. If a significant proportion of the more than 20,000 volunteer fire departments meet these restrictions, the estimated reduction in budget receipts would be substantially greater.