DESCRIPTION OF REVENUE RECONCILIATION PROPOSAL

PART TWO: EXPIRING PROVISIONS, CHILD CARE INITIATIVE, AND IRAs

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Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on October 3, 1989

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

October 3, 1989

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of Part Two of a revenue reconciliation proposal for consideration by the Senate Committee on Finance at a markup scheduled for October 3, 1989. This part describes expiring provisions, child care initiative and individual retirement accounts (IRAs).

Part One (separate JCX-57-89) describes revenue-raising provisions of the revenue reconciliation proposal.[2]

Part Three (separate JCX-59-89) describes other, miscellaneous tax provisions of the revenue reconciliation proposal.

A separate document provides estimated budget effects of the specific revenue provisions.

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1 This document may be cited as follows: Joint Committee on Taxation, Description of Revenue Reconciliation Proposal: Part Two (Expiring Provisions, Child Care Initiative, and IRAs (JCX-58-89), October 3, 1989.

2 Also, see separate document (JCX-56-89) for a description of technical corrections provisions.

H. Extensions of Expiring Tax Provisions

1. Exclusion for employer-provided educational assistance

Present Law

Under present law, an employee is required to include in income, for income and employment tax purposes, the value of educational assistance provided by an employer to the employee, unless the cost of such assistance qualifies as a deductible job-related expense of the employee. Amounts expended for education qualify as deductible job-related expenses if the education (1) maintains or improves skills required for the employee's current job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continuing employment in the same job.

Under prior law, an employee's gross income for income and employment tax purposes also 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 (sec. 127). The exclusion was limited to $5,250 of educational assistance with respect to an individual during a calendar year.

For years prior to 1988, educational assistance included assistance related to graduate-level course work. However, for years beginning in 1988, the exclusion did not apply to any payment for, or the provision of any benefits with respect to, any graduate-level courses.

The Deficit Reduction Act of 1984 required that employers file information returns with respect to educational assistance plans under section 127 (sec. 6039D). The purpose of this requirement was to collect data with respect to the use of such plans so as to provide Congress with a means to evaluate the effectiveness of the exclusion.

The educational assistance exclusion expired for taxable years beginning after December 31, 1988.

Explanation of Proposal

The exclusion for employer-provided educational assistance would be retroactively reinstated and extended so that it expires for taxable years beginning after December 31, 1991. The provision would clarify that, to the extent employer-provided educational assistance is not excludable under section 127 because it exceeds the maximum dollar limitation or because of the limitation on graduate-level courses, it may be excludable from income as a working condition fringe benefit (sec. 132(d)), provided the requirements of that section are otherwise satisfied (e.g., the education is job-related as defined under section 162). Educational assistance may not be excluded under any other provision of section 132.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1988.

2. Exclusion for employer-provided group legal services

Present Law

Under present law, amounts contributed by an employer to a group legal services plan on behalf of an employee generally are includible in the employee's gross income.

Under prior law, amounts contributed by an employer to a qualified group legal services plan for an employee (or the employee's spouses or dependents) were excluded from the employee's gross income for income and employment tax purposes (up to $70 per year) (sec. 120). The exclusion also applied to any services received by an employee or any amounts paid to an employee under such a plan as reimbursement for the cost of legal services for the employee (or the employee's spouse or dependents). In order to be a qualified plan under which employees were entitled to tax-favored benefits, a group legal services plan was required to fulfill certain requirements. The exclusion for group legal services benefits expired for taxable years ending after December 31, 1988.

In addition, under prior law, an organization, the exclusive function of which was to provide legal services or indemnification against costs of legal services as part of a qualified group legal services plan, was entitled to tax-exempt status (sec. 501(c)(20)). The tax exemption for such an organization expired for years ending after December 31, 1988.

The Deficit Reduction Act of 1984 required that employers file information returns with respect to qualified group legal services plans (sec. 6039D). The purpose of this requirement was to collect data with respect to the use of such plans so as to provide Congress with a means to evaluate the effectiveness of the exclusion.

Explanation of Proposal

The exclusion for employer-provided group legal services and the tax exemption for group legal services organizations would be retroactively reinstated and extended so that it would expire for taxable years beginning after December 31, 1991.

Effective Date

The provision would be effective for group legal services provided in taxable years ending after December 31, 1988, or taxable years of group legal services organizations ending after December 31, 1988.

3. Targeted jobs tax credit

Present Law

Tax credit provisions

A tax credit is available on an elective basis to employees of individuals from one or more of nine targeted groups. The nine groups consist of individuals who are either recipients of payments under a means-tested transfer program, economically disadvantaged (as measured by family income), or disabled.

The credit generally is equal to 40 percent of the first $6,000 of qualified first year wages. The employer's deduction for wages must be reduced by the amount of the credit.

The credit shall not apply to any amount paid or incurred to an individual who begins work for the employer after December 31, 1989.

Authorization of appropriations

Present law also authorizes appropriations for administrative and publicity expenses relating to the credit through September 30, 1989. These moneys are to be used by the IRS and Department of Labor to inform employers of the credit program.

Explanation of Proposal

Under the proposal, the credit would be extended for two years, with one modification.

The modification requires that employers specifically identify the categories (not to exceed two) for which an individual is believed to be eligible when requesting certification of individual eligibility for individuals who have not received a preliminary determination of eligibility from the designated local agency. In addition, the employer must include a statement on the certification request that a good faith effort was made to determine that the individual may be eligible for the credit.

The authorization for appropriation would also be extended for two years.

Effective Date

The proposal would extend the credit to amounts paid or incurred to a targeted-group individual who begins work for the employer after December 31, 1989, and before January 1, 1992. The credit does not apply with respect to individuals who begin work for the employer after December 31, 1991.

The proposal would also provide that the authorization for appropriations for the period October 1, 1989, through September 30, 1991 (fiscal years 1990 and 1991).

4. Research and experimentation tax credit

Present Law

Incremental credit

General rule.-- A 20-percent tax credit is allowed for qualified research expenditures incurred by a taxpayer in carrying on a trade or business. Except for certain university basic research payments, the credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed the average amount of the taxpayer's yearly qualified research expenditures in the "base period," meaning the preceding three taxable years.

The credit is scheduled to expire after December 31, 1989.

Base limitation.--The amount of base-period research expenditures is treated as equal to at least 50 percent of the taxpayer's qualified research expenditures for the current year.

Trade or business limitation.--Research expenditures of a taxpayer are eligible for the credit only if paid or incurred in a particular trade or business already being carried on by the taxpayer.

Eligible expenditures.--Research expenditures eligible for the 20-percent incremental credit consist of (1) "in-house" expenditures by the taxpayer for research wages and supplies used in research; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf.

Expenditures attributable to research which 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).

Aggregation rules and changes in business ownership.--To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related persons, research expenditures of the taxpayer are aggregated with research expenditures of certain related persons for purposes of computing any allowable credit.

Special rules apply for computing the credit when a business changes hands, under which qualified research expenditures for periods prior to the change of ownership generally are treated as transferred with the trade or business which gave rise to those expenditures.

University basic research credit

In addition to the 20-percent incremental credit, there is a 20-percent tax credit for certain corporate expenditures for university basic research. This credit applies to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research over (2) the sum of (a) the greater of two fixed 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 credit also is scheduled to expire after December 31, 1989.

Relation of credit to section 174 deduction

For taxable years beginning after 1988, the amount of any deduction allowable to a taxpayer under section 174 or any other provision for qualified research expenditures is reduced by an amount equal to 50 percent of the taxpayer's research credit determined for that year.

Explanation of Proposal

Incremental credit: sales ratio R&E tax credit

General rule

A 20-percent tax credit would be allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit would be made permanent.

The base amount for the current year would be computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years.

Fixed-base percentage

Existing firms.--If a taxpayer both incurred qualified R&E expenses and had gross receipts[1] during each of at least

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(Footnote continued)

three years from 1984 to 1988, then its "fixed-base percentage" would be the ratio that its total qualified R&E expenses for the 1984-88 period bears to its total gross receipts for this period (subject to a maximum ratio of .16, as described below).

Start-up companies.--If a taxpayer did not both incur qualified R&E expenses and have gross receipts during each of at least three years between 1984-1988, then for each of its first five taxable years after 1989 in which it incurs qualified R&E expenditures, the taxpayer would be assigned a fixed-base percentage of .03.

After its first five taxable years after 1989 in which it incurs qualified R&E expenses, a start-up firm's fixed-base percentage would be computed as follows: (1) for the firm's sixth year, its fixed-base percentage would be equal to one-sixth of its research-to-gross receipts ratio for its fourth and fifth years; (2) for the firm's seventh year, its fixed-base percentage would be one-third of its ratio for its fifth and sixth years; (3) for the firm's eighth year, its fixed-base percentage would be one-half of its ratio for its fifth through seventh years; (4) for the firm's ninth year, its fixed-base percentage would be two-thirds of its ratio for its fifth through eighth years; (5) for the firm's tenth year, its fixed-base percentage would be five-sixths of its ratio for its fifth through ninth years; and (6) after a firm's tenth year, its fixed-base percentage would be its actual research-to-gross receipts ratio for five years selected by the firm from its fifth through tenth years.

Maximum fixed-base percentage.--A taxpayer's fixed-base percentage would not exceed .16.

Base limitation

As under current law, a taxpayer's base could not be less than a certain percentage of current-year qualified R&E expenditures. The base limitation percentage for all firms would be 50 percent for taxable years beginning in 1990; 55 percent for taxable years beginning in 1991; 60 percent for taxable years beginning in 1992; 65 percent for taxable years beginning in 1993; 70 percent for taxable years beginning in 1994; and 75 percent for taxable years beginning in 1995 or later.

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[1](continued)

[1] The Treasury Department would be authorized to prescribe regulations providing that de minimis amounts of qualified R&E expenses and gross receipts may be disregarded (including under the start-up company rules described infra).

Trade or business limitation

A taxpayer would be treated as meeting the trade or business requirement with respect to in-house research expenses if, at the time such in-house research expenses are incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business of the taxpayer or certain related taxpayers.

Consistent treatment of R&E expenses

Qualified research expenses taken into account in computing a taxpayer's fixed-base percentage are to be treated on a basis which is consistent with the determination of qualified research expenses for the current year.[2]

Treasury Department study

The Trerasury Department would be required to conduct a study during each 5-year period beginning on January 1, 1990, to determine whether revenue losses from the credit are consistent with the projections, to evaluate whether the rules for computing the base for start-up firms are appropriate in view of actual trends in qualified research expenditures and gross receipts of those firms, and to analyze the effectiveness of the credit in promoting research.

Eligible expenditures

The eligible expenditures for the credit would be the same as under present law.

Aggregation rules and changes in business ownership

The rules relating to aggregation of related persons and changes in business ownership would be the same as under present law, with the modification that when a business changes hands, qualified research expenses and gross receipts for periods prior to the change of ownership would be treated as transferred with the trade or business which gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage.

In addition, a foreign affiliate's gross receipts which

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[2] The Treasury Department would be granted authority to prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts due to a change in accounting methods used by the taxpayer between the current year and a year taken into account in computing the taxpayer's fixed-base percentage.

are not effectively connected with the conduct of a trade or business in the United States would not enter into the computation of the credit.

University basic research credit

The university basic research credit would be permently extended.

Relation of credit to section 174 deduction

The amount of any deduction allowable to a taxpayer under section 174 or any other provision for qualified research expenditures would be reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

The proposal would clarify that research expenses would be deductible under section 174 only to the extent that they are reasonable under the circumstances.

Effective Date

The proposal would be effective after December 31, 1989.

5. Allocation and apportionment of research expenses

Present Law

Computation of the foreign tax credit requires the taxpayer to distinguish between taxable income from U.S. sources and taxable income from foreign sources, and thus to allocate and apportion deductions among items of U.S.-source and foreign-source gross income. Treasury regulations prescribe detailed methods for allocating and apportioning research and experimental (R&D) expenses.

The R&D allocation regulation was suspended in part by a succession of statutes, effective for taxable years beginning after August 13, 1981, and on or before August 1, 1987, as well as for each taxpayer's first taxable year beginning after August 1, 1987. In taxable years beginning after August 13, 1981 and on or before August 1, 1986, all U.S.-incurred R&D expenses were allocated to U.S.-source income. In taxable years beginning after August 1, 1986 and on or before August 1, 1987, 50 percent of such expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographic source) were allocated to U.S.-source income, with the remainder allocated and apportioned either on the basis of sales or gross income.

Expenses incurred during a taxpayer's first taxable year beginning after August 1, 1987 were given bifurcated treatment. Generally, for one third of the year's R&D expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source), 64 percent of U.S.-incurred R&D expenses was allocated to U.S.-source income, 64 percent of foreign-incurred R&D expenses was allocated to foreign-source income, and the remainder of R&D expenses was allocated and apportioned either on the basis of sales or gross income, but subject to the condition that if income-based apportionment was used, the amount apportioned to foreign-source income could be no less than 30 percent of the amount that would have been apportioned to foreign-source income had the sales method been used. Generally, for the other two thirds of the year's R&D expenses, the R&D allocation regulation applied.

Explanation of Proposal

Under the proposal, taxpayers would allocate 64 percent of expenses for R&D conducted in the United States to U.S.-source income, and would allocate 64 percent of expenses for R&D conducted outside the United States to foreign-source income. The remainder of such expenses would be apportioned on the basis of either sales or gross income, but subject to the condition that if income-based apportionment is used, the amount apportioned to foreign-source income can be no less than 30 percent of the amount that would be apportioned to foreign-source income if the sales method is used.

Effective Date

The provision would be effective for taxable years beginning after August 1, 1989, and on or before August 1, 1991.

6. Business energy tax credits

Present Law

Three nonrefundable business energy tax credits are allowed for certain types of energy property; these tax credits are scheduled to expire after December 31, 1989. The credits (the rates and the property to which they pertain) are:

(1) Business solar--10% credit;
(2) Geothermal--10%; and
(3) Ocean thermal--15%.

Under section 38, these (and other) tax credits may not be used to offset more than 25 percent of regular tax liability above $25,000 or the tentative minimum tax for the taxable year.

The expiration date for these credits was extended for one additional year, i.e., from December 31, 1988, to December 31, 1989, in the Technical and Miscellaneous Revenue Act of 1988. Earlier, these tax credit rates were extended through 1988 in the Tax Reform Act of 1986.

Explanation of Proposal

The energy tax credits for solar energy, geothermal, and ocean thermal property would be extended permanently.

Effective Date

The proposal would be effective on January 1, 1990.

7. Qualified mortgage bonds and mortgage credit certificate program

Present Law

Qualified mortgage bonds

In general

Mortgage revenue bonds qualifying for tax-exemption under section 103 of the Code ("qualified mortgage bonds") are bonds the net proceeds of which are used to finance the purchase, or qualifying rehabilitation or improvement, of single-family, owner-occupied homes located within the jurisdiction of the issuer of the bonds.

Eligible purchasers

In general, eligible purchasers must have not owned a residence within the three prior years and must have incomes below 115 percent of the median income for the area or State where the residence is located. For families consisting of less than three persons, the income limitation is 100 percent of the area or State median income.

Purchase price limitations

The acquisition cost of a residence financed with qualified mortgage bonds may not exceed 90 percent (110 percent in targeted areas) of the average area purchase price applicable to the residence.

Recapture

All or part of the subsidy provided by qualified mortgage revenue bond financing or mortgage credit certificates (described below) is recaptured on dispositions of assisted housing which occur within 10 years of purchase by mortgagors whose incomes increased substantially since purchase of their homes. The maximum amount recaptured is 1.25 percent of the original balance of the loan for each year the loan is outstanding, or 50 percent of the gain realized on the disposition, whichever is less. For sales in years six through 10, the 1.25 percent per year is phased out. This recapture provision only applies to loans originated, and mortgage credit certificates issued, after December 31, 1990.

Limitations on volume, arbitrage and unspent proceeds

Mortgage revenue bonds are subject to the general per capita volume limitation on private purpose obligations. Issuers of mortgage subsidy bonds generally must issue mortgages at rates that cannot exceed the rate of interest on the bonds by more than 1.125 percentage points. In general, bond proceeds not used to make mortgages and mortgage principal payments must be used to redeem outstanding bonds.

Sunset

The authority of State and local governments to issue tax-exempt mortgage subsidy bonds is scheduled to terminate on December 31, 1989.

Mortgage credit certificates

In general

Qualified governmental units may elect to exchange qualified mortgage bond authority for authority to issue mortgage credit certificates (MCCs) (sec. 25). MCCs entitle homebuyers to nonrefundable income tax credits (not to exceed $2,000 per year) for a specified percentage of interest paid on mortgage loans on their principal residences. Once issued, an MCC remains in effect as long as the residence being financed continues to be the certificate-recipient's principal residence. MCCs are generally subject to the same eligibility and targeted area requirements as qualified mortgage bonds.

Sunset

Mortgage credit certificates are scheduled to sunset with respect to nonissued mortgage subsidy bonds elected after December 31, 1989

Explanation of Proposal

The proposal would permanently extend the authority to issue qualified mortgage revenue bonds and to elect to trade-in bond volume authority to issue mortgage credit certificates (MCCs).

Effective Date

The proposal would be effective for bonds issued, and mortgage credit certificates issued pursuant to elections to trade-in State bond volume limitation, after December 31, 1989.

8. Qualified small-issue manufacturing bonds

Present Law

Interest on certain small issues of private activity bonds is exempt from tax if at least 95 percent of the net proceeds of the bonds is to be used to finance manufacturing facilities or certain land or property for first-time farmers ("qualified small-issue bonds").

Qualified small issue-bonds are issues having an aggregate authorized face amount (including certain outstanding prior issues) of $1 million or less. Alternatively, the aggregate face amount of the issue, together with the aggregate amount of certain related capital expenditures during the 6-year period beginning three years before the date of the issue and ending three years after that date, may not exceed $10 million. In determining whether an issue meets the requirements of the small-issue exception, certain previous small issues (and in the case of the $10-million limitation, capital expenditures during a 6-year period) are taken into account.

Interest on qualified small-issue bonds is taxable if the aggregate face amount of all outstanding tax-exempt private activity bonds (including exempt-facility bonds, qualified redevelopment bonds, and qualified small-issue bonds) that would be allocated to any beneficiary (other than a section 501(c)(3) organization) of the qualified small-issue bonds exceeds $40 million.

The aggregate amount of qualified small-issue bond financing for first-time farmers for all types of depreciable farm property (including both new and used property) is limited to $250,000 for any person or related persons. The $250,000 is a lifetime limit.

To issue a qualified bond, the issuer must receive an allocation from the State private activity volume cap. Authority to issue qualified small-issue bonds expires December 31, 1989.

Explanation of Proposal

The authority to issue small-issue bonds would be extended for two years (through December 31, 1991).

Effective Date

The proposal would be effective on the date of enactment.

ITEM	PRESENT LAW	CHAIRMAN'S MARK
1. Extension of credit	Authority to allocate low income housing tax credits expires December 31, 1989.	Provides for a permanent extension of the low-income housing credit.
2. Carryover of credit authority	Unused credit authority may not be carried forward, nor may one State's credit authority be made available for projects in another State.	Allows a one year carryforward of unused credit authority by allocating agencies. Any unused authority after such carryforward is reallocated to other States through a national pool of unused authority. Such carryover must be allocated in the year received.
3. Payment of credit	The owner of a qualifying property receives the credit over 10 years but must maintain compliance with low-income restrictions for 15 years.	Retains present law.
4. Credit recapture	Accelerated portion of credit is recaptured if the qualified basis is reduced or if the property is disposed of without posting bond satisfactory to Treasury.	Retains present law.
5. Extended low-income use and options to purchase	A building for which the owner receives a credit allocation is subject to a 15-year compliance period during which that part of the building for which the credits are claimed must be rented to low-income tenants at restricted rents.	Makes the existence of a 30 year extended low income use agreement a requirement for credit eligibility. If the taxpayer is unable to transfer property at the end of the initial compliance period for continued low-income use, the allocating agency is allowed one year (beginning at the end of the 14th year of compliance period) to find an eligible buyer at a specified price based on outstanding indebtedness and investor equity contributions. If no such buyer is located, the property may be converted to market rate use with the qualification that existing low income tenants may not be

ITEM	PRESENT LAW	CHAIRMAN'S MARK
		evicted. The determination of ownership of a qualified low income building is made without regard to options held by qualified nonprofit organizations that did not provide financing during the compliance period.
6. Allowance of credit for acquisition of existing property and substantial rehabilitation	A 70-percent present value credit may be claimed for the taxpayer's basis in both (i) new construction and (ii) qualified substantial rehabilitation expenditures; provides, in each case, that the property is not federally subsidized. A 30-percent present value credit may be claimed for the taxpayer's basis in both qualified acquisition property. To quality for the acquisition credit, substantial rehabilitation need not be undertaken. To quality as substantial rehabilitation, qualifying expenditures must average at least $2,000 per low-income unit, but need not be made on the low-income units. Expenses may be incurred over a 24-month period.	Permits the acquisition credit only if substantial rehabilitation is done and increases the minimum qualifying expenditure for substantial rehabilitation from $2,000 to $3,000 average per low-income unit.
7. Passive loss exception	A taxpayer otherwise subject to the passive loss rules is allowed up to a $25,000 deduction-equivalent amount (i.e., credit of up to $7,000) of low-income housing credits, regardless of whether the taxpayer "actively participates" in the activity. This allowance is subject to a phaseout ratably as the taxpayer's adjusted gross income increases from $200,000 to $250,000. No amount of the credit is allowed under the	Retain present law

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	special $25,000 allowance for individuals with adjusted gross income over $250,000.	
8. Federally subsidized property: Eligibility for 70 percent Credit	In general, the qualified basis of newly constructed buildings or low substantial rehabilitation expenditure which are not federally subsidized which are not federally subsidized is eligible for a 70-percent present value credit. However, the qualified basis of existing buildings and newly constructed buildings, or substantial rehabilitation expenditures, or substantial rehabilitation expenditures which are federally-subsidized is eligible for a 30-percent present value credit. Alternatively, federally-subsidized property is eligible for the 70-percent present value credit if the federal subsidy is excluded from the eligible basis. A federally-subsidized building is any building for which there was outstanding during the taxable year or any prior year a tax-exempt bond or below market Federal loan, the proceeds of which were used to finance the building or its operation. The qualified basis of a qualified low-income building for any taxable year is determined by multiplying the eligible basis of the building by the lesser of (i) the ratio of number of low-income units to all units in the building, or (ii) the ratio of the floor space of low-income units to floor space of all units.	Retains present law, except as to definition of "substantial rehabilitation".
9. Tax-exempt bond financed property: Annual credit limitation	When 70 percent or more of the aggregate basis of a building and the land on which	Retains present law

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ITEM	PRESENT LAW	CHAIRMAN'S MARK
	it is located is financed with the proceeds of tax-exempt bonds which are subject to the State's bond volume cap the owner may claim the 30-percent present value credit for the entire eligible basis of the building without receiving an allocation under the State's annual credit cap.	
10. High-cost areas	A maximum 70-percent present value credit is available for new construction and substantial rehabilitation expenditures..	Increases the maximum credit available to buildings in certain high-cost and very poor areas (up to a 91 percent present value credit).
11. 10-year rule	Generally, properties placed in service within the last 10 years are ineligible for the credit. Exceptions are provided for buildings transferred in which the new owner retains the basis of the previous owner. When the transferor is a qualified tax-exempt organization or a governmental entity, the 10-year rule is applied by looking to the placed in service date of the most recent taxable owner. In addition, exceptions to the 10-year rule are provided (sec. 42(d)) for certain properties, a default on which would result in a Federal Government budget outlay.	Grants a new exception from the 10-year rule for: 1) for certain buildings acquired from failed financial institutions; 2) certain properties which would convert to market use and which are owned by HUD or the Farmers Home Administration or where HUD holds the mortgage loan on the building; and 3) low-income buildings the mortgages on which are subject to prepayment if the exception is necessary to avert conversion of the properties to market rate use. Also, expands definition of "federally-assisted building" to include building with four or more units with mortgages originated by or insured or guaranteed by the Federal Government.
12. Credit and HUD section 8 programs	The credit is available to qualifying properties which also receive direct Federal	Provides that the credit is not available to property receiving assistance under the

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	assistance under HUD Section 8 programs.	HUD Section 8 mod rehab program.
13. Single room occupancy units	A single room occupancy unit is eligible for the credit if the unit is subject to a six-month lease.	Provides that month-to-month leases do not disqualify single room occupancy units for the credit
14. Four-unit, owner-occupied structures	Owner-occupied buildings with four or fewer units are ineligible for the credit.	Expands eligibility for the credit to owner-occupied buildings having four or fewer units. The expansion only applies to acquisition and rehabilitation of buildings pursuant to a development plan sponsored by a State or local government or qualified nonprofit.
15. Special needs services	Non-housing services may be provided to tenants in rent-restricted units on an optional basis. If such services are mandatory and paid for by the tenant, charges for them are added to rental charges and subject to the 30-percent gross rent restriction.	Expands eligibility of the credit for certain special needs housing and increases current rent restrictions by 20 percent in the case of certain fees paid to owners by governmental units for "supportive services"
16. Scattered site projects	All units in a project must be located on contiguous geographic sites.	Treats scattered site housing as one project if 100 percent of dwelling units are qualified low-income units and there is common plan of financing.
17. Credits allocated to projects	Credits are allocated to buildings, although compliance is determined on a project basis.	Allows an allocation of credit on a project, rather than a building basis
18. Determination of eligible basis	For the new construction credit, eligible basis is determined at the placed in service date. For the acquisition and substantial rehabilitation credits eligible basis is determined at the end of the first taxable year of the credit period. This determination will be made before depreciation is taken into account.	Provides that the determination of eligible basis for all credits is made at the end of the first taxable year of the credit period. This determination will be made before depreciation is taken into account

ITEM	PRESENT LAW	CHAIRMAN'S MARK
19. Determination of rent for rent-restricted units	Maximum allowable rents for rent-restricted units are determined by 30 percent of qualifying income limitation adjusted for family size.	Uses apartment size rather than family size of occupants as the basis for gross rent limitation. Uses actual family size as basis for qualifying low-income tenant.
20. Rent floors	For rent-restricted units, the rent is determined by taking 30 percent of the qualifying income limitation. Annually, as the qualifying income limitation changes, the allowable rent may change.	Retains present law.
21. Rents for previously qualifying tenants whose incomes now exceed the qualifying income limitations	A tenant who qualified for a rent-restricted unit may continue to be deemed to qualify even if his/her income grows to as much as 140 percent of the qualifying income limitation. The maximum allowable rent is still determined by 30 percent of the qualifying income limitation.	Retains present law.
22. Deep rent skewing	To qualify under the deep rent skewing exception, at least 15 percent of the low-income units must be occupied by tenants whose incomes do not exceed 40 percent of area median income, the rents must be restricted to 30 percent of the qualifying income limitation, and rents on the market rate units must be at least 300 percent of rents charged on comparable rent restricted units.	Liberalizes the deep rent skewing rules by changing 300 percent to 200 percent.
23. At-risk rule for qualified nonprofit organizations	Treats as an amount at risk certain nonrecourse financing provided by a qualified nonprofit organization, provided that certain requirements are met including that the financing is repaid within 90 days after the end of the 15-year compliance period.	Expands the present law at-risk rules for property financed by qualified nonprofit organizations by delaying the deadline for full repayment of such financing to conform to extended use period.
24. State plans	Credits are allocated by	Mandates the development of a

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	State allocating agencies.	plan of allocation by State allocating agencies. Among the location criteria are inclusion of local charities and encouragement of mixed use housing.
25. Allocation of only necessary credits	For new or substantially rehabilitated property, allocating agencies may allocate up to a 70 percent present value credit. For acquisition property and Federally-subsidized property, the allocating agency may allocate up to a 30-percent present value credit.	Mandates that credit allocations to a building not exceed the level necessary for the financial feasibility of the project
26. Project evaluation	Allocating agencies may use any guidelines they choose to allocate credits to eligible properties.	Mandates State allocating agency evaluation of each credit project according to pre established criteria
27. Semiannual determination of credit percentage	Credit percentages are determined monthly by the Secretary.	Retains present law.
28. Credit claimed for buildings placed in service in later years.	Generally credit may be claimed only for property placed in service in the year the credit allocation is received. An exception exists for newly constructed or substantially rehabilitated property which is not substantially financed with tax exempt bonds. This exception permits credits to be claimed for property placed in service within two years after a credit allocation was received, if 10 percent of estimated project costs were incurred in the year in which the allocation was made.	Provides that newly constructed or substantially rehabilitated property which is substantially financed with tax-exempt bonds may claim the credit for buildings placed in service within two years after the bonds were issued, if at least 10 percent of estimated project costs were incurred by the close of the calendar year in which the bonds were issued.
29. Administrative provisions	Requires that credit forms be filed within 90 days after the end each taxable year in the credit period.	Allows the taxpayer to file credit forms on the same day as required for filing tax returns.
30. Effective date	The credit is scheduled to	The proposal is generally

ITEM	PRESENT LAW	CHAIRMAN'S MARK
	expire after December 31, 1989.	effective for determinations made under section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

10. Health insurance deduction for self-employed individuals

Present Law

Under present law, self-employed individuals are entitled to deduct 25 percent of the amount paid for health insurance for the individual and the individual's spouse and dependents (sec. 162(l)). This deduction expires for taxable years beginning after December 31, 1989.

Under present law, more than 2-percent shareholders of S corporations are generally treated as partners in a partnership for purposes of the employee fringe benefit provisions of the Code (sec. 1372).

Explanation of Proposal

The proposal would extend the 25-percent deduction so that it expires for taxable years beginning after December 31, 1991. The proposal would also provide that the 25-percent deduction applies to a more than 2-percent shareholder (as defined under sec. 1372). For purposes of the 25-percent deduction, such an individual's earned income is determined exclusively by reference to the individual's wages (as defined in sec. 3121) from the S corporation. The Secretary is authorized to prescribe additional adjustments relating to application of the deduction in the case of S corporation shareholders.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1989.

11. ESOP exception to additional tax on early withdrawals

Present Law

Under present law, an additional 10-percent income tax applies to early withdrawals from a qualified retirement plan. However, certain distributions from an employee stock ownership plan (ESOP) or a tax credit ESOP are exempt from the additional income tax to the extent that the distribution is attributable to assets that have been invested, at all times, in employer securities (as defined in sec. 409(l)) that satisfy the applicable requirements of sections 409 and 401(a)(28) for the 5-year period immediately preceding the plan year in which the distribution occurs (sec. 72(t)(2)(C)). The ESOP exception does not apply to distributions made after December 31, 1989.

Explanation of Proposal

Under the proposal, the exception to the early withdrawal tax for certain distributions from an ESOP would be extended for 2 years so that it applies to distributions made before January 1, 1992.

Effective Date

The proposal would be effective for distributions after December 31, 1989.

I. Child Care Initiative and Telephone Excise Tax[1]

1. Dependent care tax credit; credit for health insurance premiums; supplemental earned income tax credit for families with young children

Present Law

Dependent care credit

Under present law, an individual may be entitled to a nonrefundable tax credit equal to a percentage of the employment-related child or dependent care expenses paid by the individual for the taxable year to enable the individual to work (sec. 21). The maximum amount of the credit is 30 percent of allowable employment-related expenses. This 30 percent is reduced by one percentage point for each $2,000 (or fraction thereof) of the taxpayer's adjusted gross income (AGI) between $10,000 and $28,000. The credit rate is 20 percent for taxpayers with AGI in excess of $28,000.

The maximum amount of expenses that may be taken into account in calculating the credit is limited to $2,400 per year in the case of one qualifying individual and $4,800 in the case of more than one qualifying individual. In addition, the maximum amount of expenses taken into account cannot exceed the individual's earned income or, in the case of married taxpayers, the lesser of the individual's earned income or the earned income of his or her spouse.

A "qualifying individual" is (1) a dependent of the taxpayer who is under the age of 13 and with respect to whom the taxpayer is entitled to claim a dependent exemption, (2) a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself, or (3) the spouse of the taxpayer, if the spouse is physically or mentally incapable of caring for himself or herself.

Tax provisions relating to individual health insurance

Present law generally does not provide tax benefits specifically designed to encourage the purchase of health insurance by individuals; however, present law does provide certain tax benefits for health insurance in particular circumstances. Under present law, health insurance that is paid by an employer is generally excluded from an employee's gross income. In addition, self-employed individuals are

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[1] The provisions in this part are equivalent to those included in S.5, as passed by the Senate, or as previously approved by the Finance Committee with an effective date modification.

entitled to deduct 25 percent of the amount paid for medical insurance for the individual or his or her spouse or dependents; this provision is scheduled to expire for taxable years beginning after December 31, 1989.

Taxpayers who itemize deductions may deduct expenses for medical care (not compensated by insurance or otherwise) of the taxpayer or his or her spouse or dependents to the extent such expenses exceed 7.5 percent of the taxpayer's adjusted gross income. Premiums paid for health insurance qualify for the deduction.

Earned income tax credit

The earned income tax credit (EITC) provides an advanced refundable tax credit to taxpayers who maintain a household for one or more children. In 1989, the credit is equal to 14 percent of the first $6,500 of earned income. The credit is phased out at a rate of 10 percent of the amount of adjusted gross income (or, if greater, the earned income) that, in 1989, exceeds $10,240. The $6,500 and $10,240 amounts are adjusted annually for inflation, so that the maximum credit amount and the maximum amount of income eligible for the credit increase with inflation.

Explanation of Proposals

Dependent care credit

The proposal would make the present-law dependent care credit partially refundable and available through advance payments. That is, taxpayers who do not have sufficient taxable income to offset the credit would be entitled to receive 90 percent of the credit that is not offset against tax liability in cash. Refundable amounts may be received through the year as advance payments from the employer. However, under the proposal, taxpayers with adjusted gross income (AGI) in excess of $28,000 would not be entitled to claim the refundable credit, but instead would be eligible for the nonrefundable dependent care credit as under present law.

Health insurance credit

The proposal would amend the dependent care credit to add a new advance refundable credit for health insurance expenses. The proposal would provide that an individual who maintains a household containing one or more qualifying individuals is entitled to a credit equal to 50 percent of the individual's qualified health insurance expenses that do not exceed $1,000. The 50 percent credit percentage is reduced by 5 percentage points for each $1,000 (or fraction thereof) by which the taxpayer's adjusted gross income (AGI) exceeds $12,000. Thus, the credit is zero for taxpayers with AGI in excess of $21,000.

Qualified health insurance expenses would be amounts paid during the taxable year for health insurance that includes coverage for one or more qualifying individuals. For purposes of this credit, a qualifying individual would be a dependent of the taxpayer who is under age 19 and with respect to whom the taxpayer can claim a dependent exemption.

Supplemental earned income credit

A supplemental credit of 7 percent of the first $6,500 of earned income (as adjusted for inflation), but not to exceed $500, would be provided for families with one qualifying child. The percentage for families with two or more qualifying children would be 10 percent and the credit could not exceed $750. A qualifying child would be one for whom the taxpayer maintains a household and has not attained the age of four. The supplemental credit would be phased out at a rate of 15 percent (10 percent for a taxpayer with only one qualifying child) of the amount of adjusted gross income (or, if greater, the earned income) that exceeds the lesser of $10,000 (as adjusted for inflation), or $12,000.

Child health demonstration projects

The proposal would authorize the appropriation of $25 million for each of the fiscal years 1990 through 1994 to enable the Secretary of Health and Human Services to conduct demonstration projects to evaluate and extend health insurance to children under age 19 who are not covered by other public or private health programs.

GAO study

The General Accounting Office (GAO), in consultation with the Internal Revenue Service (IRS), would be required to conduct a study to determine (1) the effectiveness of the advance payment system and (2) how to implement such a system to avoid administrative complexity for small business and report its recommendations within one year after enactment.

Effective Dates

In general, the proposals would be effective for taxable years beginning after December 31, 1990. Advance refundability of the dependent care credit and the health insurance credit would be effective for tax years beginning after December 31, 1991.

2. Estimated tax payment for certain subchapter S income

Present Law

In general, an S corporation is not subject to tax on its taxable income. Rather, taxable income of an S corporation flows through to its shareholders in a manner similar to a partnership. However, there are limited instances when an S corporation is subject to tax. These instances include: (1) the recognition of a built-in gain within 10 years of the date that a former C corporation elected S corporation status (sec. 1374(a)); (2) the receipt of passive investment income in excess of 25 percent of total annual gross receipts if the corporation has earnings and profits from a year in which it was not an S corporation (sec. 1375(a)); and (3) the recapture of investment tax credits claimed during a taxable year in which the corporation was not an S corporation (sec. 1371(d)).

Although situations exist for which an S corporation is liable for income tax, present law does not require the corporation to make estimated tax payments. Instead, the tax must be paid no later than the unextended due date of the S corporation tax return.

Explanation of Proposal

The proposal provides that an S corporation would be required to make estimated tax payments if it has tax attributable to: (1) the recognition of built-in gains under section 1374(a);[1] (2) the receipt of excess passive investment income under section 1375(a); or (3) the recapture of investment tax credits pursuant to section 1371(d).[2] The rules contained in section 6655 for estimated tax payments by corporations would generally apply.

For purposes of the portion of required estimated tax payments attributable to built-in gains and investment tax credit recapture, an S corporation would not be able to utilize the exceptions which allow estimated tax payments to be based on the corporation's prior year tax (secs. 6655(d)(1)(B)(ii) and 6655(d)(2)(B)). The prior year's tax exception would be available to all S corporations (including "large" S corporations) with respect to the portion of

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[1] The proposal would also apply to tax that is attributable to certain capital gains of S corporations pursuant to sec. 1374 as effective before the changes made by the Tax Reform Act of 1986.

[2] No inference would be intended as to the proper estimated tax treatment for any item for any prior year or for any item for any taxpayer other than an S corporation.

required estimated tax payments attributable to excess passive income (even if there was no tax attributable to excess passive income in the prior year). In all situations, an S corporation would be able to use the annualization exception (sec. 6655(e)).

Effective Date

The proposal would be effective for estimated tax payments due for taxable years beginning after December 31, 1989.

3. Extension of the telephone excise tax; modification of tax collection period

Present Law

Imposition of tax

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service (sec. 4251). The tax is collected by the provider of the service from the consumer (business and personal service). The tax is scheduled to expire after December 31, 1990.

The 3-percent telephone excise tax was last extended for 3 years (1988-1990) in the Omnibus Budget Reconciliation Act of 1987. The 3-percent tax was previously extended for 2 years (1986-1987) in the Deficit Reduction Act of 1984.

Collection of tax

Under present law, the telephone tax billed to the customer in a semi-monthly period is considered to be collected from the customer during the second following semi-monthly period. Such tax must be deposited in a Federal Reserve Bank or other authorized depository within 3 banking days after the end of the semi-monthly period for which the tax is considered collected. (Rev. Proc. 76-45, 1976-2 C.B. 668).

Explanation of Proposal

Extension of tax

The 3-percent telephone excise tax would be made permanent. The Administration's budget proposal recommended making the tax permanent.

Modification of collection period

Under the proposal, the tax for a semi-monthly period would be considered collected during the first week of the second following semi-monthly period. The tax would be required to be deposited within 3 banking days after the end of the week for which such tax is considered to be collected.

Effective Date

The proposal to extend the telephone excise tax would be effective on January 1, 1991. The proposal with respect to the time the tax is considered collected would be effective with respect to taxes considered collected for semi-monthly periods beginning after June 30, 1990.

J. Individual Retirement Accounts (IRAs)

Present Law

Under present law, the maximum deductible contribution that can be made to an individual retirement account (IRA) is generally the lesser of $2,000 or 100 percent of an individual's compensation. Individuals who are not active participants in an employer-sponsored retirement plan, single taxpayers with adjusted gross income (AGI) of less than $25,000, and married taxpayers with AGI of less than $40,000, may make the maximum deductible contribution. For taxpayers who are active participants in employer-sponsored retirement plans, the IRA deduction is phased out for single taxpayers with AGI between $25,000 and $35,000, and for married taxpayers with AGI between $40,000 and $50,000.

Taxpayers who are not entitled to the maximum IRA deduction may make nondeductible contributions to IRAs. As is the case with earnings on deductible IRA contributions, earnings on nondeductible contributions accumulate on a tax-deferred basis.

Amounts withdrawn from IRAs (other than nondeductible contributions) are includible in income when withdrawn. Early withdrawals, e.g., withdrawals prior to age 59-1/2, death, or disability, are generally subject to an additional 10-percent income tax (sec. 72(t)).

Explanation of Proposal[1]

In general

The deductibility of an individual's contributions to an IRA is expanded under the proposal. Generally, the proposal permits a deduction of one-half of the otherwise nondeductible portion of the contribution made by an individual. The proposal also allows withdrawals from an IRA without imposition of the additional 10-percent tax to the extent the amount withdrawn is used for either the purchase of a first home or for certain education expenses.

Expansion of present-law deduction rules

Under the proposal, an individual who contributes to an IRA may deduct the amount of the contribution that is deductible under present law, plus 50 percent of the contribution that is not deductible under present law. This

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[1] This proposal is substantially the same as the provisions of S. 1678, The Savings and Investment Incentive Act of 1989, which was introduced on September 27, 1989, by Senator Bentsen and others.

additional 50-percent deduction is only allowed with respect to contributions that would otherwise have been deductible but for the active participant rule. The present-law maximum dollar limitation ($2,000) and other limitations relating to deductibility (e.g., the requirement that the IRA owner be under the age of 70-1/2) continue to apply.

The proposal also provides that interest on loans the proceeds of which are directly traceable to an IRA contribution is nondeductible.

<u>Withdrawals by first-time home buyers</u>

Under the proposal, withdrawals by first-time homebuyers that are used within 60 days to acquire, construct, or reconstruct the taxpayer's principal residence are not subject to the 10-percent additional tax. A first-time homebuyer is an individual who has not had an ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which the withdrawal relates. The date of acquisition is the date the individual enters into a contract to purchase a principal residence or begins construction or reconstruction of such a residence. The proposal requires that the spouse of the taxpayer also meet this requirement as of the date of acquisition. Principal residence is defined as under the provisions relating to the rollover of gain on the sale of a principal residence (sec. 1034).

Under the proposal, any amount withdrawn from an IRA for the purchase of a principal residence is to be used within 60 days of the date of withdrawal. The 10-percent additional income tax is imposed with respect to any amount not so used. However, if the 60-day rule cannot be satisfied due to a delay in the acquisition of the residence, the taxpayer may recontribute to an IRA all or part of the amount withdrawn prior to end of the 60-day period. Any amount recontributed is generally treated as a rollover contribution (sec. 408(d)), except that the frequency limitation on rollovers between IRAs does not apply.

<u>Rules relating to expenses for education</u>

Under the proposal, withdrawals used by a taxpayer during the year for qualified higher education expenses are not subject to the 10-percent additional tax. Qualified higher education expenses are tuition, fees, books, supplies, and equipment required for courses at an eligible educational institution. Amounts withdrawn may be used for the education of the taxpayer, or the taxpayer's spouse, dependents, or grandchildren.

The amount that may be withdrawn for educational expenses for a taxable year without imposition of the

10-percent tax is reduced by any amount that is excludable from the taxable income of the taxpayer under the provisions relating to educational savings bonds.

Effective Date

The expansion of the deduction provisions would be effective for taxable years beginning after December 31, 1990. The provisions relating to the exceptions to the 10-percent additional income tax would apply to distributions after December 31, 1989. The provision relating to interest on funds borrowed to make IRA contributions would be effective for debt incurred after the date of enactment.