

[JOINT COMMITTEE PRINT]

**EXPLANATION OF MISCELLANEOUS  
TAX PROPOSALS**

SCHEDULED FOR HEARINGS

BEFORE THE

**SUBCOMMITTEE ON  
SELECT REVENUE MEASURES**

OF THE

**HOUSE COMMITTEE ON WAYS AND MEANS  
ON FEBRUARY 21-22, 1990**

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PREPARED BY THE STAFF

OF THE

**JOINT COMMITTEE ON TAXATION**



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101ST CONGRESS, 2D SESSION

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# CONTENTS

	Page
INTRODUCTION .....	1
EXPLANATION OF MISCELLANEOUS TAX PROPOSALS .....	3
A. Foreign Tax Provisions.....	3
1. Extension of carryforward of foreign tax credits..	3
2. Carryforward of pre-1987 foreign base company shipping losses.....	3
3. Characterization of successive loans (sec. 956) .....	5
4. Treatment of related party royalties under subpart F of the Code .....	6
5. Exceptions to PFIC rules .....	7
a. Manufacturing operations in trade deficits countries .....	7
b. Exception for certain shareholders of publicly traded corporations .....	8
6. Treatment of foreign insurance companies.....	10
7. Treatment of certain interest earned by brokers or dealers for purposes of the foreign personal holding company rules .....	12
8. Convention treatment of certain cruise ships .....	13
9. Application of the mirror tax system to Guam.....	14
10. Modification of the reinsurance excise tax .....	15
B. Accounting Provisions .....	17
1. Installment sales treatment of certain dispositions of used automobiles (H.R. 2041).....	17
2. Treatment of certain crops under the annual accrual method of accounting .....	18
3. Modify the look-back method for long-term contracts.....	18
4. Exception to required use of an accrual method of accounting for certain corporations earning commission income. ....	19
C. Alternative Minimum Tax.....	21
1. Treatment of certain small property and casualty insurance companies under the alternative minimum tax.....	21
2. Extension of relief from prior law alternative minimum tax for farm insolvency transactions...	21

	Page
3. Treatment of charitable contributions of appreciated property under the alternative minimum tax .....	22
D. Pension and Employee Benefit Provisions .....	23
1. Permit tax-exempt employers to maintain section 401(k) cash or deferred arrangements.....	23
2. Modify certain rules relating to voluntary employees' beneficiary associations (VEBAs).....	23
3. Expansion of separate testing rule for pilots with respect to certain pension nondiscrimination rules.....	24
4. Individual retirement account (IRA) limitation modification.....	25
5. Modification of minimum participation rule for plans of public safety employees .....	25
6. Application of limitations on pension benefits for clergy .....	26
E. Employee Stock Ownership Plans (ESOPs): Gratuitous Transfers.....	27
F. Estate and Gift Taxes .....	28
1. Special use valuation of farm property for estate tax purposes .....	28
2. Disclaimer of gifts .....	28
3. Annual exclusion for gift tax and definition of a present interest.....	30
4. Cap on State death tax credit.....	30
G. Other Proposals .....	32
1. Treatment of gain from the sale or exchange of property that effectuates the policy of the Federal Communications Commission.....	32
2. Contributions in aid of construction of regulated water utilities.....	33
3. Treatment of nuclear decommissioning funds.....	34
4. Treatment of tuxedos held for rental.....	34
5. Treatment of interest on indebtedness with respect to certain life insurance contracts.....	35
6. Treatment of gain or loss on sale of assets by cooperative associations .....	35
7. Sports facility bonds .....	37
8. Treatment of income from personal injury awards for minor children.....	38
9. Deductibility of fees for "New Communities Act" associations.....	39
10. Tax treatment of public transit and van pool benefits.....	39
11. Deductibility of student loan interest .....	40
12. Deductibility of certain flight-training expenses ..	41

	Page
13. Extend eligibility for the earned income tax credit to military personnel stationed overseas ...	41
14. Additional low-income housing tax credit allocation .....	42



## INTRODUCTION

The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means has scheduled public hearings on February 21-22, 1990, on additional miscellaneous tax proposals. The proposals scheduled for the hearings generally are issues raised by Members during the Committee's consideration of 1989 revenue reconciliation proposals, and which were deferred pending Subcommittee hearings.

This pamphlet,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides an explanation of the miscellaneous tax proposals scheduled for the hearings. Prior Subcommittee hearings (101st Cong.) were held on other miscellaneous tax proposals on October 12, 1989, and October 26, 1989.<sup>2</sup>

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<sup>1</sup> This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Miscellaneous Tax Proposals* (JCS-4-80), February 14, 1990.

<sup>2</sup> For a description of previous Subcommittee hearings on other miscellaneous tax proposals, see: Joint Committee on Taxation, *Description of Miscellaneous Tax Proposals* (JCS-12-89), October 6, 1989 (also JCX-64-89, October 11, 1989, for an additional item for the October 12 hearing); Joint Committee on Taxation, *Description of Additional Miscellaneous Tax Proposals* (JCX-66-89), October 20, 1989 (also JCX-68-89, October 23, 1989, for an additional item for the October 26 hearing).



## EXPLANATION OF MISCELLANEOUS TAX PROPOSALS

### A. Foreign Tax Provisions

#### 1. Extension of carryforward of foreign tax credits

##### *Present Law*

If a taxpayer chooses to have the benefits of the foreign tax credit provisions of the Code for any taxable year, current foreign income taxes in excess of the relevant current-year foreign tax credit limitation are not creditable against current U.S. tax liabilities. However, such excess foreign tax credits generally may be carried back for two years and carried forward for five years, and used as a credit to the extent there is excess foreign tax credit limitation (i.e., an excess of the foreign tax credit limitation over creditable foreign taxes) in any of those years (sec. 904(c)). The unused credit is applied first against any excess limitation of the second preceding year, then against any excess limitation of the first preceding year, and is then carried forward to the first, second, and succeeding carryover years until it is fully used or until the expiration of the five-year period.

##### *Explanation of Proposal*

The proposal would permit foreign tax credits to be carried forward for up to 15 years.

##### *Effective Date*

The proposal would apply to foreign tax credits arising in taxable years beginning after December 31, 1988.

#### 2. Carryforward of pre-1987 foreign base company shipping losses

##### *Present Law*

Under subpart F of the Code, certain types of income of U.S.-controlled foreign corporations are included currently in shareholder income and taxed by the United States regardless of whether the income is actually distributed currently to shareholders. Types of income deemed distributed (generally referred to as "subpart F income") include foreign base company sales income, foreign base company services income, foreign base company shipping income, foreign base company oil related income, and foreign personal holding company income (collectively referred to as foreign base company income), and certain insurance income.

The amount of subpart F income of a controlled foreign corporation that is included in the income of the foreign corporation's U.S. shareholders for any year is limited by the earnings and profits of the foreign corporation for that year. Moreover, if a controlled for-

eign corporation runs a deficit in earnings and profits for a taxable year, then under certain circumstances that deficit can reduce future U.S. shareholder taxation that would otherwise occur under subpart F. To the extent that the deficit is attributable to certain qualified activities of the foreign corporation giving rise to subpart F income in a later year, the amount of the later-year subpart F income generated by that qualified activity and included in the income of the foreign corporation's U.S. shareholders is generally reduced.

The rules of subpart F were originally enacted in the Revenue Act of 1962, generally effective for taxable years of foreign corporations beginning after 1962. Rules treating foreign base company shipping income as subpart F income were enacted in the Tax Reduction Act of 1975, generally effective for taxable years of foreign corporations beginning after 1975. Rules treating foreign base company oil related income as subpart F income were enacted in the Tax Equity and Fiscal Responsibility Act of 1982, generally effective for taxable years of foreign corporations beginning after 1982.

The Tax Reform Act of 1986 substantially increased the effective subpart F taxation of foreign base company shipping income, subpart F insurance income, and foreign personal holding company income. Moreover, the 1986 Act, as amended by the Technical and Miscellaneous Revenue Act of 1988, substantially restricted the availability of prior year deficits to reduce current year subpart F inclusions.

Under pre-1986 Act law, foreign base company shipping income that was reinvested by a controlled foreign corporation in foreign shipping operations was excluded from foreign base company income (former sec. 954(b)(2)). (By the same token, a U.S. shareholder was (and still is) subject to a subpart F income inclusion upon withdrawal of the controlled foreign corporation's previously excluded subpart F income from foreign base company shipping operations.) The 1986 Act, which for this purpose generally applies only to taxable years beginning after 1986, repealed the reinvestment exception to subpart F taxation.

Also under pre-1986 Act law, subpart F inclusions of U.S. shareholders were reduced by deficits for prior years beginning after 1962 without regard to the type of activities generating the deficit or the type of controlled foreign corporation income for which the U.S. shareholder income inclusion was reduced (former sec. 952(c)). Currently, if a qualified activity gives rise to foreign base company sales or services income, deficits from that activity for years beginning after 1962 may be used to reduce only those subpart F inclusions attributable to foreign base company sales or services income, as the case may be. If the qualified activity gives rise to foreign base company oil related income, deficits from that activity for years beginning after 1982 may be used to reduce subpart F inclusions, and only those subpart F inclusions attributable to foreign base company oil related income may be so reduced. In these cases, then, deficits may be carried forward so long as they were generated in a year for which income from the activity was subpart F income subject to current inclusion under the then-current provisions of the Code.

If on the other hand the qualified activity gives rise to foreign base company shipping income, foreign personal holding company income of a qualified insurance company or a qualified financial institution, or subpart F insurance income of a qualified insurance company, only deficits for years beginning after 1986 may be used to reduce subpart F inclusions (again, only those subpart F inclusions attributable to activities giving rise to the deficits may be reduced by those deficits). In these cases, then, deficits may be carried forward only if they were generated in a year for which income from the activity was subpart F income subject to current inclusion under the rules as expanded by the 1986 Act.

### *Explanation of Proposal*

If a qualified activity of a controlled foreign corporation gives rise to foreign base company shipping income, then under certain circumstances deficits attributable to such activities for years beginning after 1975 and before 1987 may be used to reduce subpart F inclusions of income from those activities. Pre-1987 deficits may be used if substantially all of the total of the amounts of foreign base company shipping income of the controlled foreign corporation for each of its taxable years beginning after 1975 and before 1987 (counting only those years, if any, for which those amounts were positive) either was currently included in the corporation's foreign base company income (without reduction under the reinvestment rule) or was included in the gross income of the corporation's U.S. shareholder or shareholders in a taxable year beginning before 1987. In addition, deficits permitted to be carried forward and used under this rule would be reduced by any amount excluded from the controlled foreign corporation's subpart F income (and not subsequently included in the U.S. shareholder's gross income) due to the shipping reinvestment rule.

### *Effective Date*

The proposal would apply to taxable years of foreign corporations beginning after December 31, 1990.

## **3. Characterization of successive loans (sec. 956)**

### *Present Law*

A U.S. shareholder of a controlled foreign corporation is generally taxable on his pro rata share of the controlled foreign corporation's subpart F income. In addition, a U.S. shareholder of a controlled foreign corporation is generally taxable on his pro rata share of the corporation's increase for the year in earnings invested in U.S. property (secs. 951(a)(1)(B) and 956). Such increase is measured by comparing the controlled foreign corporation's total amount of earnings invested in U.S. property at the close of its current taxable year with the corresponding amount at the close of its preceding taxable year.

The term U.S. property, for purposes of section 956, generally includes obligations issued by a U.S. shareholder of the controlled foreign corporation (sec. 956(b)(1)(C)).

In a recent ruling, the IRS considered two examples involving fact patterns where controlled foreign corporations made loans to U.S. shareholders, which loans were repaid before the close of the taxable year of the corporations, and then new loans were made early in the next taxable year (Rev. Rul. 89-73, 1989-21 I.R.B. 19). In the ruling, the IRS determined that where a loan from a controlled foreign corporation to its U.S. shareholder remained outstanding for over nine months and was repaid one and one-half months prior to the close of the corporation's taxable year, and was followed by the creation of a new loan between the parties 15 days into the corporation's next taxable year (which loan also remained outstanding for over nine months), the brief period of time between the termination of the investment and subsequent reinvestment in U.S. property should be disregarded. Therefore the ruling provides that such an investment by a controlled foreign corporation in obligations issued by its U.S. shareholder is to be considered in substance as an investment in U.S. property that was outstanding at the close of the taxable year for purposes of section 956.

The ruling provided a second example under which a loan that remained outstanding for five months was repaid six months prior to the close of the controlled foreign corporation's taxable year, followed by the creation of a new loan (with a duration of 10 months) 15 days into the next year. In that case, the IRS ruled that the period of time between the termination of the first loan and the creation of the second loan was not sufficiently brief, compared to the overall period the obligations were outstanding, to be disregarded. Thus, the IRS ruled that the obligations did not represent an investment in U.S. property that was outstanding at the close of the taxable year for purposes of section 956.

### *Explanation of Proposal*

The proposal would make Revenue Ruling 89-73 prospective only.

### *Effective Date*

The proposal would cause Revenue Ruling 89-73 to be effective only for taxable years beginning after May 23, 1989.

## **4. Treatment of related party royalties under subpart F of the Code**

### *Present Law*

Foreign personal holding company income, for subpart F purposes, generally includes income such as dividends, interest, royalties, rents, annuities, net gains from the disposition of certain property that generated no income or other foreign personal holding company income, as well as certain net foreign currency gains. Foreign personal holding company income does not include rents and royalties received from unrelated persons that are derived in the active conduct of a trade or business. Foreign personal holding company income also does not include royalties received from a related corporation for the use of, or the privilege of using, property within the country under the laws of which the controlled foreign corporation is created or organized.

Foreign base company sales income includes certain income derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person. In order for such income to be foreign base company sales income, the property must be manufactured, produced, grown, or extracted outside the country under the laws of which the controlled foreign corporation is created or organized, or the property must be sold (or purchased, in the case of property purchased on behalf of a related person) for use, consumption or disposition outside such foreign country.

Accordingly, subpart F income generally includes royalties from the *license* of a product, such as computer software, by a controlled foreign corporation that produces the product locally in its home country and licenses to a related controlled foreign corporation, organized under the laws of a second foreign country, which in turn distributes the product for use in the second foreign country. On the other hand, subpart F income generally does not include income from the *sale* of a product by a controlled foreign corporation that produces the product locally in its home country and sells to a related controlled foreign corporation, organized under the laws of a second foreign country, which in turn distributes the product for use in the second foreign country.

### ***Explanation of Proposal***

In the case of a U.S. computer software company with a foreign production affiliate that licenses products to foreign sales affiliates for relicensing to customers, treat related-party royalties paid for software licensed by the production affiliate to the sales affiliates, for subpart F purposes, as if they were payments for the sale of property (i.e., under the foreign base company sales income rules generally applicable to manufacturers rather than under the foreign personal holding company income rules).

### ***Effective Date***

The proposal would be effective for taxable years beginning after the date of enactment.

## **5. Exceptions to PFIC rules**

### **a. Manufacturing operations in trade deficit countries**

#### ***Present Law***

Generally a passive foreign investment company (PFIC) is any foreign corporation if either 75 percent or more of its gross income for the taxable year consists of passive income (the "income test"), or 50 percent or more of the average fair market value (or at the election of the foreign corporation, the average adjusted bases) of its assets consists of assets that produce, or are held for the production of, passive income (the "asset test").

Passive income generally is defined as any income of a kind that would be foreign personal holding company income as defined in section 954(c), with certain exceptions relating to banking, insurance, and related-party income (sec. 1296(b)).

U.S. persons that own stock in a PFIC are subject to tax on their pro rata share of the earnings of the PFIC under either of two regimes. If the PFIC is a qualified electing fund (QEF), U.S. shareholders of that PFIC are generally required to include in gross income their pro rata share of the PFIC's ordinary earnings and net capital gain for the taxable year. If the PFIC is not a QEF, U.S. shareholders recognize income when actual distributions are made by the PFIC. Upon receipt of an excess distribution (the portion of any distribution in excess of 125 percent of the average distributions for the prior three years) from the PFIC, a U.S. shareholder must pay a deferred tax amount with respect to any portion of such distribution that is treated as arising out of earnings from a year other than the current year of the PFIC. The deferred tax amount includes both a computation of tax based on the highest rate of tax in effect during the taxable year in which the earnings were generated, plus an interest charge based on the deferral period.

### *Explanation of Proposal*

The proposal would exempt from the asset test any corporation that is a controlled foreign corporation (as defined in section 957(a)), and that engages in substantial manufacturing or production activities in a foreign country which had a deficit in its balance of trade with the United States for the calendar year preceding the calendar year in which the taxable year begins. The proposal would only be effective with respect to shareholders of the foreign corporation that are U.S. shareholders as defined in Code section 951(b). Thus, if such a corporation fails the asset test, the proposal would cause the corporation to be treated as a PFIC only with respect to those shareholders who are not U.S. shareholders under section 951(b).

### *Effective Date*

The proposal would be effective for taxable years of foreign corporations beginning after December 31, 1986. The proposal would not be effective with respect to any corporation that is created or organized under the laws of Panama for any period during which IRS Notice 88-47, 1988-1 C.B. 530, is in effect.

### **b. Exception for certain shareholders of publicly traded corporations**

#### *Present Law*

Generally under present law, a foreign corporation that is a foreign investment company (FIC) to which the rules of section 1247 apply is not treated as a PFIC. The rules of section 1247 can apply to a FIC only if the FIC made an election prior to 1963 to have those rules apply. If section 1247 applies, then the rules of section 1246 will not apply with respect to certain shareholders of the FIC.

Instead, the corporation must annually distribute to its shareholders 90 percent of its taxable income (computed without regard to certain items, including net capital gain). Regardless of the date of acquisition of PFIC stock or the amount of stock held, all U.S. persons that own such stock are subject to the special PFIC rules (secs. 1291-1297).

The rules for PFICs that are not QEFs contain provisions which are designed to prohibit avoidance of tax on the appreciation of PFIC stock. One such provision denies a step-up in the basis of PFIC stock to fair market value upon death of the stockholder (sec. 1291(e)). A second provision permits the Treasury to disregard any nonrecognition provision that might otherwise apply to the transfer of stock in a PFIC. For example, the Treasury may require gain recognition upon a charitable contribution of PFIC stock (sec. 1291(f)). These rules do not apply to a qualified electing fund.

### *Explanation of Proposal*

The proposal has three parts. Under the first part of the proposal, a foreign corporation that is a FIC would be allowed a 6-month period after enactment of the proposal to elect treatment under section 1247 beginning with its first taxable year beginning after December 31, 1986.<sup>3</sup> Certain requirements would apply to a corporation electing under the proposal, in addition to the requirements of current section 1247. First, an electing corporation would be required to distribute 90 percent or more of its taxable income (computed with the adjustments provided under section 1247). Second, an electing corporation would be required to provide to its shareholders who are U.S. persons information that is sufficient for them to compute their pro rata shares of the corporation's ordinary earnings and net capital gains. The shareholders who are U.S. persons would be required to include such income of the FIC in their own income, subject to the PFIC rules for basis adjustments and previously taxed amounts. Third, an electing corporation would be required to represent, at the time the election is made, that it has no intention to invest in the stock of any corporation which it reasonably believes to be a PFIC. Fourth, the requirements of section 1247 relating to shareholder notice, earnings and profits adjustments, and stock basis adjustments would all apply to an electing corporation as if they required notice of, and adjustment for, ordinary earnings and net capital gain.

The second part of the proposal is a transitional rule that would exempt from the PFIC rules certain stock of a corporation if that stock is part of a class of stock the shares of which are regularly traded in the United States through unsponsored American Depository Receipts (ADRs). To qualify for this exemption (1) the stock would have to be held by a person who acquired such stock before October 22, 1986 and who has never held, directly or indirectly, more than 1 percent of such class of stock; (2) the class of stock (or ADRs) would have to be included in the National Association of Securities Dealers Automated Quotation (NASDAQ) System, would have to have been initially included in that system prior to October

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<sup>3</sup> This date is also the original effective date of the PFIC provisions of the Code.

1983, and could not also be traded on a regulated exchange in the United States; (3) U.S. ownership of that class of stock could not exceed 30 percent; and (4) the corporation could not have a distribution policy, the principal purpose of which is the avoidance of tax by its shareholders that are U.S. persons.

The third part of the proposal would provide certain relief from the antiavoidance provisions related to basis step-up at death and charitable contributions of PFIC stock. Under the proposal, the denial of basis step-up at death would not apply to the portion of the appreciation in PFIC stock which is allocable to the period before the original effective date of the PFIC rules. In addition, in the case of a charitable contribution of PFIC stock, the proposal would exempt from gain recognition the portion of gain allocable to such pre-effective date period.

### *Effective Date*

The proposal would be effective for the first taxable year of a foreign corporation beginning after December 31, 1986. The time for making an election under the first part of the proposal would be extended to the date six months after the date of enactment.

## **6. Treatment of foreign insurance companies**

### *Present Law*

A foreign company that is carrying on an insurance business in the United States generally is taxed in the same manner as a U.S. insurance company on its income that is effectively connected with its conduct of a U.S. trade or business. The net investment income of a foreign insurance company that is effectively connected with the conduct of an insurance business in the United States, however, may not be less than the required U.S. assets of the company for the taxable year multiplied by the domestic investment yield applicable to the company for the taxable year.

The required U.S. assets of a foreign insurance company for any year are determined by multiplying the mean of the company's total insurance liabilities on U.S. business by the domestic asset/liability percentage applicable to the company. For each year, the Treasury Secretary prescribes a domestic asset/liability percentage for foreign life insurance companies and a separate domestic asset/liability percentage for foreign property and casualty insurance companies. The domestic asset/liability percentage for each type of insurance company equals a fraction, the numerator of which is the mean of the assets of the domestic companies of such type and the denominator of which is the mean of the total insurance liabilities of the domestic companies of such type.

In addition, for each year, the Treasury Secretary prescribes a domestic investment yield for foreign life insurance companies and a separate domestic investment yield for foreign property and casualty insurance companies. The domestic investment yield for each type of insurance company equals a fraction, the numerator of which is the net investment income of domestic companies of such type and the denominator of which is the mean of the aggregate assets of the domestic companies of such type.

The Treasury Secretary is to determine the domestic asset/liability percentage and the domestic investment yield for each type of insurance company on the basis of data derived from a representative sample of domestic insurance companies. For any taxable year, the domestic asset/liability percentages and the domestic investment yields are to be based on data from the second preceding taxable year.

If the net investment income of a foreign insurance company that is effectively connected with the conduct of a U.S. business is increased as a result of this provision, the amount of the withholding tax on investment income that is not effectively connected with a U.S. business is to be reduced. The amount by which the 30-percent withholding tax is to be reduced for any taxable year is not to exceed the increase in tax for such year that is attributable to the minimum effectively connected net investment income provision.

The Treasury Secretary is authorized to promulgate such regulations as may be necessary or appropriate to effectuate the purposes of the provision including regulations that provide proper adjustments in succeeding taxable years where the actual effectively connected net investment income of a foreign insurance company for any year exceeds the minimum effectively connected net investment income of such insurance company for such year. The Treasury Secretary is also authorized to issue regulations that provide for separate domestic asset/liability percentages and separate domestic investment yields for different types of property and casualty insurance companies. Regulations relating to the minimum effectively connected net investment income provision have not yet been issued.

### *Explanation of Proposals*

#### *Recomputation of effectively connected net investment income in subsequent year*

The effectively connected net investment income of a foreign insurance company for any taxable year would equal the actual effectively connected net investment income of the company for such year. The amount of effectively connected net investment income of such company for such taxable year would be recomputed in a subsequent year when data is available with respect to domestic insurance companies for such taxable year.

#### *Cumulative determination of effectively connected net investment income*

The effectively connected net investment income of a foreign insurance company for any taxable year would be determined on the basis of the greater of (1) the cumulative actual effectively connected net investment income or (2) the cumulative minimum effectively connected net investment income.

#### *Interaction with withholding tax on non-effectively connected net investment income*

As under present law, if the net investment income of a foreign insurance company that is effectively connected with the conduct of a U.S. business is increased as a result of this provision, the

amount of the withholding tax on investment income that is not effectively connected with a U.S. business would be reduced. Unlike present law, the amount by which the 30-percent withholding tax is reduced for any taxable year would be limited to the sum of (1) any increase in tax for such year that is attributable to the minimum effectively connected net investment income provision and (2) any reduction in a net operating loss for such year that is attributable to the minimum effectively connected net investment income provision.

### *Regulations relating to property and casualty insurance companies*

The Treasury Secretary would be required to issue regulations that provide for separate domestic asset/liability percentages and separate domestic investment yields for different types of property and casualty insurance companies.

### *Effective Date*

The proposals would apply as if included in the Revenue Act of 1987.

## **7. Treatment of certain interest earned by brokers or dealers for purposes of the foreign personal holding company rules**

### *Present Law*

Under present law, the undistributed foreign personal holding company income of a foreign personal holding company (FPHC) is treated as having been distributed by the FPHC on the last day of the taxable year during which the income was earned (sec. 551(a)). Each U.S. person that owns stock in the FPHC is required to include in gross income its pro rata share of the deemed distribution from the FPHC (sec. 551(b)).

An FPHC is any foreign corporation that during a taxable year satisfies both a gross income requirement and a stock ownership requirement. The gross income requirement is met if at least 60 percent of the corporation's gross income during a taxable year consists of foreign personal holding company income (as defined in section 553).<sup>4</sup> The ownership test is satisfied if at any time during a taxable year more than 50 percent of either the voting power or value of the stock of the corporation is held directly, or indirectly, by five or fewer individuals who are U.S. citizens or residents.

As a general rule, the term foreign personal holding company income includes income such as dividends, interest, royalties, and annuities (sec. 553(a)(1)). As such, the term includes interest earned by a foreign corporation in the ordinary course of its business as a broker or dealer of securities.

The Code provides rules for personal holding companies (PHCs), that is, domestic corporations that are closely held and which earn significant passive-type income (secs. 541-547), that are in some ways similar to the FPHC rules. For purposes of the PHC rules, interest received by brokers or dealers in connection with securities

<sup>4</sup> For certain taxable years subsequent to a taxable year for which a corporation qualifies as an FPHC, the 60-percent threshold is reduced to 50 percent.

or money market instruments held as inventory, margin accounts, or any financing for a customer which is secured by securities or money market instruments is excluded from the types of passive income which can cause a company to be treated as a PHC.

Conversely, subpart F of the Code contains other rules designed to limit the opportunities of U.S. persons to defer the recognition of taxable income by conducting operations through a controlled foreign corporation (secs. 951-964). Similar to the FPHC rules, the subpart F rules treat interest received by brokers or dealers in the active course of their business as income for which deferral is not granted.

### *Explanation of Proposal*

The proposal would exclude from the definition of foreign personal holding company income certain interest received by a broker or dealer in connection with (1) any securities or money market instruments which are held as inventory, (2) margin accounts, or (3) any financing for a customer secured by securities or money market instruments. For purposes of this rule, a broker or dealer would be any person that meets such definition under section 3(a)(4) or (5) of the Securities and Exchange Act of 1934, whether or not the person is registered under such act. In addition, the term "dealer" would include only a regular dealer that is licensed or otherwise authorized to engage in the business of dealing in stock or securities under the laws of the country in which it does business. The proposal would apply only if the taxable income of the broker or dealer was subject to foreign income tax at an effective rate which is greater than 90 percent of the maximum U.S. corporate tax rate.

### *Effective Date*

The proposal would be effective for interest received in taxable years ending after the date of enactment.

## **8. Convention treatment of certain cruise ships**

### *Present Law*

A deduction, not to exceed \$2,000 per individual, is allowed under section 162 for conventions held aboard cruise ships if (1) reporting and business-purpose requirements are met, (2) the cruise ship is a vessel registered (i.e., documented) in the United States (a U.S.-flag vessel), and (3) all ports of call of that cruise ship are located in the United States or in possessions of the United States (sec. 274(h)(2)). Prior to 1982, no deductions were allowed for any expenses of a convention held on a cruise ship.<sup>5</sup>

In order to be documented in the United States for *domestic* or *coastal* transportation, a vessel must be built in the United States, be owned by a U.S. person (including a U.S. corporation or partnership that is ultimately owned at least 75 percent by U.S. individ-

<sup>5</sup> In permitting such deductions, the Committee on Ways and Means expressed the view that the automatic disallowance of deductions for cruise ship conventions worked to the detriment of the U.S.-flag cruise ship industry. H.R. Rep. No. 97-828, 97th Cong., 2d Sess. 3 (1982).

uals), satisfy U.S. Coast Guard safety standards, and employ only U.S. citizens for its crew. In the case of *international* (including Caribbean) transportation, a U.S.-flag vessel need not be U.S. built or ultimately U.S. owned. A U.S.-flag commercial vessel is subject to requisition by the United States in time of war. The availability of foreign-flag vessels for requisition by the United States is uncertain.

Generally, deductions for expenses of attending conventions on land outside "the North American area" are limited or disallowed under special rules not applicable to conventions held within the North American area. The term North American area includes Bermuda, and any "beneficiary country" under the Caribbean Basin Initiative (CBI), if that country has entered into a tax information exchange agreement with the United States meeting certain requirements and if that country's tax laws have not been found to discriminate against conventions held in the United States.

### *Explanation of Proposal*

The proposal would permit deductions of up to \$2,000 per individual for expenses on account of conventions, seminars, and other meetings aboard (1) certain foreign-flag vessels making at least one port call in nondiscriminatory beneficiary countries, and (2) all U.S. flag vessels making such port calls, assuming all other existing requirements are met. A "nondiscriminatory beneficiary country" for this purpose is one whose tax laws have not been found to discriminate against conventions held in the United States. Cruises on foreign-flag vessels would qualify for deductions under the proposal only if (a) at least 20 percent of the crew for that cruise (including food service and cabin workers as well as the vessel's operating crew) consists of citizens or residents of one or more nondiscriminatory beneficiary countries, and (b) the group attending the convention, seminar, or other meeting does not exceed 500.

### *Effective Date*

The proposal would be effective for conventions, seminars, and other meetings beginning after the date of enactment.

## **9. Application of the mirror tax system to Guam**

### *Present Law*

Presently, the income tax laws of the United States are in effect in Guam, that is, Guam's tax laws are generally a mirror image of the Internal Revenue Code. To transform the Internal Revenue Code into a mirror code, the word "Guam" is substituted for "United States" where appropriate.

Provisions of the Tax Reform Act of 1986 will eventually eliminate the requirement that Guam employ the mirror system of taxation.<sup>6</sup> These provisions will be effective only if (and so long as) an

<sup>6</sup> Prior to the 1986 Act, Guam was required to use the mirror code under the Organic Act of 1950.

implementing agreement is in effect between the United States and Guam. There is an executed implementing agreement between the United States and Guam which takes effect January 1, 1991. Generally the agreement is intended to provide for mutual assistance in tax matters, including exchanges of information, for purposes of administering the tax laws of Guam and the United States and especially to prevent avoidance or evasion of those laws.

Under one of the 1986 Act provisions to become effective upon the effective date of the implementing agreement, Guam will be granted full authority under its own local income tax system with respect to income from sources within, or effectively connected with the conduct of a trade or business within, Guam, and with respect to any income received or accrued by any resident of Guam. Under another such provision of the 1986 Act, the "single filing rule" (sec. 935) will be repealed. Under that rule, individuals who are residents of Guam, citizens of Guam, or U.S. citizens or residents with Guam source income, are required to file only one tax return for each year, either with the U.S. or Guam (depending on the taxpayer's status), and the Treasuries of the United States and Guam apportion the tax payments as appropriate.

### *Explanation of Proposal*

Under the proposal, notwithstanding the January 1, 1991 effective date of the U.S.-Guam implementing agreement, Guam would remain on the mirror code unless and until the Government of Guam adopts a new comprehensive territorial income tax code and the Governor of Guam certifies that fact to the U.S. Treasury Department. In addition, section 935 as in effect prior to the 1986 Act would continue to apply unless and until Guam goes off the mirror code.

### *Effective Date*

The proposal would be effective as if included in the 1986 Act.

## **10. Modification of the reinsurance excise tax**

### *Present Law*

The Code generally imposes an excise tax on each policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer to or for or in the name of a domestic corporation or partnership, or a U.S. resident individual with respect to risks wholly or partly within the United States, or to or for or in the name of any foreign person engaged in business within the United States with respect to risks within the United States (sec. 4371). The tax does not apply, however, to any amount effectively connected with the conduct of a trade or business within the United States (unless such amount is exempt from the net-basis U.S. tax under a treaty) (sec. 4373(1)).

The tax is imposed at the following rates: (1) 4 percent of the premium paid on a casualty insurance policy or indemnity bond; (2) 1 percent of the premium paid on a policy of life, sickness, or accident insurance, or annuity contracts on the lives or hazards to the person of a U.S. citizen or resident; and (3) 1 percent of the premi-

um paid on a policy of reinsurance covering any of the contracts taxable under (1) or (2).

The tax is waived in United States tax treaties with the United Kingdom, France, Cyprus, Italy, and certain other countries. These treaties were negotiated and entered into force prior to the significant changes, enacted in the Tax Reform Act of 1986 and subsequent Acts, in the U.S. taxation of property and casualty insurance income earned by U.S. companies and by foreign companies conducting an insurance business within the United States. The tax would also be waived upon entry into force of certain treaties and draft treaties awaiting further action prior to ratification, including the as-yet unratified treaty with Germany. Generally, these treaty waivers include an anti-conduit rule denying the benefit of the exemption to premiums covering risks that are reinsured with a person not entitled to a similar treaty exemption. Notably, however, the U.K. treaty has no anti-conduit rule.

### *Explanation of Proposal*

Under the proposal, the excise tax on property and casualty reinsurance premiums would be raised from 1 percent to 4 percent. In addition, this increase would override any treaty waiver of the tax.

### *Effective Date*

The proposal would be effective for premiums attributable to reinsurance coverage for periods after the date of enactment.

## **B. Accounting Provisions**

### **1. Installment sales treatment of certain dispositions of used automobiles (H.R. 2041)**

#### *Present Law*

##### *Treatment of dealer dispositions*

The installment method of accounting may not be used in determining the amount of income that is recognized for any taxable year from a dealer disposition of property. For this purpose, a dealer disposition of property includes (1) any disposition of personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan, and (2) any disposition of real property that is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business. A dealer disposition of property does not include (1) any disposition of property that is used or produced in the trade or business of farming, and (2) any disposition of a timeshare or residential lot if the taxpayer elects to pay interest on the amount of deferred tax that is attributable to the use of the installment method.

##### *Treatment of nondealer dispositions*

Special rules apply if the installment method is used with respect to nondealer dispositions of property with a sales price in excess of \$150,000 (other than personal use property, property used or produced in the trade or business of farming, and timeshares and residential lots with respect to which interest is paid). First, an interest charge is imposed on the tax that is deferred under the installment method to the extent attributable to the amount by which the deferred payments arising from all dispositions of such property during any year exceed \$5 million. Second, if any indebtedness is secured directly by an installment obligation that arises out of the disposition of such property, the net proceeds of the secured indebtedness are treated as a payment received under such installment obligation.

#### *Explanation of Proposal*

Under the proposal (H.R. 2041), any taxpayer who is a licensed used automobile dealer would be allowed to use the installment method of accounting with respect to the disposition of any used automobile in the ordinary course of the taxpayer's trade or business if the following conditions are satisfied. First, the used automobile must be more than 3 years old at the time of the disposition and the sales price of such automobile must not exceed \$6,000. Second, the installment obligation must arise solely from such dis-

position and the term of the installment obligation (including extensions) must not exceed 36 months. Third, the face amount of all installment obligations of the taxpayer (and certain related persons) that arise from such dispositions during any taxable year and that are outstanding as of the close of such taxable year must not exceed \$4 million. Fourth, the taxpayer must pay interest on the total amount of deferred tax that is attributable to the use of the installment method with respect to such dispositions.

#### *Effective Date*

The proposal would apply to dispositions occurring after December 31, 1987.

### **2. Treatment of certain crops under the annual accrual method of accounting**

#### *Present Law*

In order to provide an accurate measure of income for any year, the uniform cost capitalization rules generally require taxpayers that are engaged in the production of property or that acquire property for resale to capitalize or include in inventory costs that are allocable to the property. An exception to the uniform cost capitalization rules is provided for certain corporations and qualified partnerships that are permitted to use the annual accrual method of accounting with respect to the trade or business of farming sugar cane. Under the annual accrual method of accounting, revenues, costs, and expenses are determined under an accrual method of accounting, and the preproductive period expenses incurred during any taxable year are charged to harvested crops or are deducted in determining taxable income for such year.

#### *Explanation of Proposal*

Any corporation or qualified partnership that, for its last taxable year ending before January 1, 1987, was allowed to use, and actually did use, the annual accrual method of accounting with respect to any crop would be allowed to continue to use such method of accounting with respect to such crop.

#### *Effective Date*

The proposal would apply as if included in the Tax Reform Act of 1986.

### **3. Modify the look-back method for long-term contracts**

#### *Present Law*

Taxpayers engaged in the production of property under a long-term contract generally must compute income from the contract under the percentage of completion method. Under the percentage of completion method, a taxpayer must include in gross income for any taxable year an amount that is based on the product of (1) the gross contract price and (2) the percentage of the contract completed during the year. The percentage of the contract completed

during the year is determined by comparing the costs incurred with respect to the contract as of the end of the year with the estimated total contract costs.

At the time the contract is completed, a determination is made whether the taxes paid with respect to the contract for each year of the contract were greater than or less than the amount that would have been due if gross income had been computed by using the actual total contract price and costs, rather than the estimated contract price and costs. Interest must be paid by the taxpayer, if after applying this "look-back" method, there is an underpayment of tax by the taxpayer with respect to a taxable year. Similarly, interest must be paid to the taxpayer by the Internal Revenue Service if there has been an overpayment of tax with respect to a taxable year. In applying the look-back method, any item of income or cost received or accrued after the completion of the contract is taken into account by discounting the amount of such item to its value as of the completion of the contract. The taxpayer may elect with respect to any contract not to discount amounts received or accrued after the completion of the contract.

### *Explanation of Proposal*

The look-back method would not apply to an amount received after the completion of a long-term contract if the amount is received as a result of disputes, litigation, or settlements related to the contract.

### *Effective Date*

The proposal would be effective for contracts entered into after December 31, 1989.

## **4. Exception to required use of an accrual method of accounting for certain corporations earning commission income**

### *Present Law*

Corporations generally must compute taxable income by using an accrual method of accounting. Exceptions are provided for certain farm corporations, corporations with average annual gross receipts since 1985 of \$5 million or less, and qualified personal service corporations. For this purpose, a qualified personal service corporation is a corporation substantially all the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and substantially all the stock of which is owned by persons who perform or performed such services.

### *Explanation of Proposal*

A corporation would not be required to use an accrual method of accounting in computing taxable income if (1) more than 50 percent of the corporation's income over the taxable year and two preceding taxable years is commission income; (2) the corporation pays at least 25 percent of the commission income to brokers; and (3) the

commission income will be received in installments due in more than one taxable year.

*Effective Date*

The proposal would be effective as if included in the Tax Reform Act of 1986.

## **C. Alternative Minimum Tax**

### **1. Treatment of certain small property and casualty insurance companies under the alternative minimum tax**

#### *Present Law*

Present law provides that certain small property and casualty insurance companies may elect to be taxed only on taxable investment income for regular tax purposes (sec. 831(b)). Eligible property and casualty insurance companies are those whose net written premiums (or if greater, direct written premiums) for the taxable year exceed \$350,000 but do not exceed \$1,200,000.

Under present law, all corporations including insurance companies are subject to an alternative minimum tax. For taxable years beginning before 1990, alternative minimum taxable income is increased by one-half of the amount by which the corporation's pre-tax book income exceeds the corporation's alternative minimum taxable income (determined without regard to this adjustment and without regard to net operating losses). For taxable years beginning after 1989, alternative minimum taxable income is increased by 75 percent of the excess of adjusted current earnings over alternative minimum taxable income (determined without regard to this adjustment and without regard to net operating losses).

#### *Explanation of Proposal*

Under the proposal, a small property and casualty insurance company that elects to be taxed on taxable investment income would determine its minimum tax liability without regard to underwriting income and expense.

#### *Effective Date*

The proposal would apply as if included in the Tax Reform Act of 1986.

### **2. Extension of relief from prior law alternative minimum tax for farm insolvency transactions**

#### *Present Law*

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) provided that certain transfers by insolvent farmers did not give rise to a tax preference for capital gains under the alternative minimum tax as in effect prior to the enactment of the Tax Reform Act of 1986. The provision was effective for taxable years beginning after December 31, 1981.

### *Explanation of Proposal*

The proposal would apply the COBRA provision to taxable years beginning after December 31, 1978. The proposal would extend the statute of limitations on refunds or credits resulting from the enactment of this proposal to one year after date of enactment.

#### *Effective Date*

The proposal would apply to taxable years beginning in 1979, 1980, and 1981.

### **3. Treatment of charitable contributions of appreciated property under the alternative minimum tax**

#### *Present Law*

Under present law, corporations and individuals are subject to an alternative minimum tax liability which is payable, in addition to all other tax liabilities, to the extent that it exceeds the taxpayer's regular income tax liability. Individuals are subject to an alternative minimum tax imposed at a 21 percent rate on the taxpayer's alternative minimum taxable income. Corporations are subject to a minimum tax at the rate of 20 percent.

Alternative minimum taxable income generally is the taxpayer's regular taxable income increased by certain tax preferences and adjusted by determining the tax treatment of certain items in a manner that negates the exclusion or deferral of income resulting from the regular tax treatment of such items. In determining the amount of tax, alternative minimum taxable income is reduced by a phased-out exemption amount not to exceed \$40,000.

In computing taxable income for regular tax purposes, a taxpayer generally is allowed to deduct the fair market value of property contributed to a charitable organization.<sup>7</sup> In computing alternative minimum taxable income, the deduction for charitable contributions generally is not allowed to the extent the fair market value of the property contributed exceeds the adjusted basis of the property. In effect, the taxpayer is required to include in alternative minimum taxable income the amount of previously unrecognized appreciation with respect the contributed property.

#### *Explanation of Proposal*

Under the proposal, the provision of present law denying a charitable deduction for the amount of appreciation with respect to contributed property for purposes of the alternative minimum tax (sec. 57(a)(6)) would be repealed.

#### *Effective Date*

The proposal would apply to contributions made after date of enactment.

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<sup>7</sup> The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, or the income of the taxpayer.

## **D. Pension and Employee Benefit Provisions**

### **1. Permit tax-exempt employers to maintain section 401(k) cash or deferred arrangements**

#### *Present Law*

Under present law, if a tax qualified profit-sharing or stock bonus plan meets certain requirements, then an employee is not required to include in income any employer contributions to the plan merely because the employee could have elected to receive the amount contributed in cash (sec. 401(k)). State and local governments and nongovernmental tax-exempt organizations are generally prohibited from establishing qualified cash or deferred arrangements. This prohibition does not apply with respect to certain State and local government plans that were in existence on May 6, 1986, or plans maintained by other tax-exempt organizations that were in existence on July 2, 1986.

#### *Explanation of Proposal*

The proposal would allow nongovernmental tax-exempt organizations to maintain cash or deferred arrangements for their employees.

#### *Effective Date*

The proposal would be effective with respect to plans established after December 31, 1989.

### **2. Modify certain rules relating to voluntary employees' beneficiary associations (VEBAs)**

#### *Present Law*

A voluntary employees' beneficiary association ("VEBA") that provides for the payment of life, sick, accident, or other similar benefits to its members, their dependents, or other similar beneficiaries may qualify for exemption from income taxation if certain requirements are met (sec. 501(c)(9)). Under Treasury regulations, one of these requirements is that the members have an employment-related common bond determined by reference to objective standards.

Under the regulations, employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to have an employment-related common bond. The Internal Revenue Service has taken the position that the geographic locale requirement is not met if membership in a VEBA is available on a multi-state basis to employees whose sole common bond is their employment with unaffiliated employers that are

members of a trade association (unless the multi-state area is a single metropolitan area or similarly restricted geographic locale).

Present law imposes limits on the deductibility of contributions to certain welfare benefit funds, including VEBAs. These limitations generally do not apply to VEBAs which are part of a 10 or more employer plan. A 10 or more employer plan is defined as a plan to which more than 1 employer contributes and to which no employer normally contributes more than 10 percent of the total annual contributions under the plan.

In general, income set aside by a VEBA to provide for the payment of life, sick, accident, or certain other benefits generally is subject to tax as unrelated business income to the extent that such amounts exceed the amount necessary to meet the costs of providing current coverage and for permissible adjustments for existing excess reserves. The limit on permissible set-asides applies without regard to whether or not the VEBA is a 10 or more employer VEBA.

### *Explanation of Proposal*

The proposal would eliminate the geographic locale restriction contained in the Treasury regulations. In addition, the definition of a 10 or more employer plan would be modified. Under the proposal, the 10-percent contribution limit would be increased to 25-percent if the plan had more than 15 contributing employers. Finally, 10 or more employer plans would not be subject to the rule treating excess set-asides as unrelated business taxable income.

### *Effective Date*

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

### **3. Expansion of separate testing rule for pilots with respect to certain pension nondiscrimination rules**

#### *Present Law*

Under present law, a pension plan is not a qualified plan under the Code unless it meets certain minimum coverage requirements (sec. 410(b)). In general, all employees of an employer who meet certain age and service requirements must be considered in determining whether a plan meets the minimum coverage requirements. An exception exists with respect to certain airline pilots. Under this exception, in the case of a trust established or maintained under a collective bargaining agreement between airline pilots represented in accordance with title II of the Railway Labor Act and one or more employers, employees covered by such agreement are tested separately from other employees (sec. 410(b)(3)(B)). This exception does not apply in the case of a plan that covers employees whose principal duties are not customarily performed aboard an aircraft in flight.

### *Explanation of Proposal*

The proposal would provide that airline pilots are tested for purposes of the minimum coverage requirements under the present-law rule for pilots without regard to whether the pilots are covered under a collective bargaining agreement.

#### *Effective Date*

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

## **4. Individual retirement account (IRA) limitation modification**

### *Present Law*

Under present law, the maximum deductible contribution to an individual retirement account (IRA) is available with respect to taxpayers with adjusted gross income (AGI) below a certain level and to taxpayers who are not active participants in an employer-maintained retirement plan. An individual is considered an active participant for a taxable year if the individual (or the individual's spouse) is an active participant for any part of the plan year ending with or within the individual's taxable year.

### *Explanation of Proposal*

Under the proposal, for taxpayers with AGI above the applicable dollar amount, the limit on deductible IRA contributions would be reduced in proportion to the number of months in which the taxpayer (or the taxpayer's spouse) is an active participant in an employer-sponsored retirement plan.

#### *Effective Date*

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

## **5. Modification of minimum participation rule for plans of public safety employees**

### *Present Law*

Under present law, a pension plan is not a qualified plan unless it benefits no fewer than the lesser of 50 employees of the employer or 40 percent of the employer's employees.

### *Explanation of Proposal*

Under the proposal, the minimum participation rule would not apply to a plan for qualified public safety employees if (1) no new participants are added to the plan after July 17, 1989, and (2) the plan satisfied the minimum participation rule on July 17, 1989. A qualified public safety employee is an employee of a police department or fire department organized and operated by a State or political subdivision if the employee provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision.

*Effective Date*

The proposal would be effective upon the date of enactment.

**6. Application of limitations on pension benefits for clergy***Present Law*

Under present law, gross income does not include the rental value of a home furnished to a minister as part of his or her compensation or a rental allowance paid to a minister as part of compensation to the extent the allowance is used to rent or provide a home. Present law also places limits on the contributions and benefits under a tax-qualified pension plan. In the case of a defined benefit pension plan, the limit on the annual benefit that may be provided under the plan is generally the lesser of (1) 100 percent of average compensation, or (2) \$102,582. For purposes of the compensation limit, compensation generally includes taxable compensation and thus, for example, does not include parsonage allowances that are excludable from gross income.

*Explanation of Proposal*

Under the proposal, up to \$15,000 of an excludable parsonage allowance would be treated as compensation for purposes of applying the maximum limits on contributions and benefits under a defined benefit pension plan.

*Effective Date*

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

## **E. Employee Stock Ownership Plans (ESOPs): Gratuitous Transfers**

### *Present Law*

In determining Federal estate tax, a deduction is allowed for certain contributions for public, charitable, and religious uses (sec. 2055). No deduction is allowed for a transfer of a remainder interest in trust, unless such interest is in a charitable remainder trust or pooled income fund (sec. 2055(e)(2)(A)).

Charitable remainder trusts are not subject to income tax (unless the trust has unrelated business taxable income). Amounts paid to the income beneficiary of the trust may be taxable to the beneficiary, depending on their character.

In general, a charitable remainder trust is a trust (1) from which a sum certain or a fixed percentage of trust assets is to be paid periodically to one or more persons, (2) from which no amount other than such payments may be paid to or for the use of any person other than a charitable organization (as defined in sec. 170(c)), and (3) following the termination of such payments, the remainder interest in the trust is to be transferred to, or for the use of, a charitable organization or is retained by the trust for such a use.

### *Explanation of Proposal*

The proposal would allow a deduction in determining Federal estate tax for employer securities transferred to an employee stock ownership plan (ESOP) in a "qualified gratuitous transfer". For income tax purposes, a trust in which the remainder interest consists of qualified employer securities which are to be transferred in a qualified gratuitous transfer would be treated the same as a charitable remainder trust.

A transfer would be a qualified gratuitous transfer to the extent that (1) the securities were received by a trust from a decedent, (2) no deduction under section 404 (relating to contributions to tax-qualified pension plans) is allowed with respect to the transfer, (3) the ESOP provides that the securities are allocated to plan participants in a manner that does not discriminate in favor of highly compensated employees, (4) the ESOP treats the securities as attributable to employer contributions, and (5) certain other requirements are met with respect to the allocation of the securities to plan participants.

### *Effective Date*

The proposal would apply to transfers by a trust to or for the use of an ESOP after the date of enactment.

## F. Estate and Gift Taxes

### 1. Special use valuation of farm property for estate tax purposes

#### *Present Law*

If the executor so elects, the value of real property used by the decedent as a farm or other trade or business is its value in the use as a farm or other trade or business instead of its value in its highest and best use. In order to qualify for special use valuation, the real property must be used by the decedent or a member of the decedent's family as a farm for farming purposes or in another trade or business. An additional tax is imposed if the family member who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death. Cash rental of specially valued property after the death of the decedent is not a qualified use and, therefore, is treated as a recapture event.

The election must be made on the estate tax return. For decedents dying after December 31, 1981, the election may be made on a late return if that return is the first estate tax return filed.

#### *Explanation of Proposals*

##### *Proposal 1*

A qualified heir's cash rental of specially valued real property to a lineal descendant would not result in the property failing to be treated as used in a qualified use for purposes of the special use valuation recapture tax.

##### *Proposal 2*

For decedents dying after December 31, 1976, the election for special use valuation could be made on a late return if that return is the first estate tax return filed. Alternatively, an election filed on a late return would be valid only if a court or other supervisory body determined that the attorney responsible for filing the return was negligent or committed malpractice in failing to file a timely return.

#### *Effective Date*

The proposals would be effective for rentals occurring, and decedents dying, after December 31, 1976.

### 2. Disclaimer of gifts

#### *Present Law*

In general, a disclaimer is a refusal to accept the ownership of property or rights with respect to property. If a qualified disclaim-

er is made, the Federal estate, gift, and generation-skipping transfer tax provisions apply with respect to the property interest disclaimed as if the interest had never been transferred to the person making the disclaimer. Thus, the transfer of property pursuant to the disclaimer will not be treated as a taxable gift.

Prior to the enactment of section 2518 in 1976, there were no uniform Federal disclaimer rules. Before the promulgation of regulations in 1958, the administrative practice of the Internal Revenue Service was to allow the Federal tax consequences of a disclaimer to depend upon its treatment under local law.

On November 14, 1958, the Treasury Department issued regulations (T.D. 6334) which required that a disclaimer (1) be effective under local law and (2) notwithstanding the timeliness of the disclaimer under local law, be made "within a reasonable time after knowledge of the existence of the transfer." In litigating this issue, the Internal Revenue Service took the position that these regulations required that a disclaimer be made within a reasonable time after the creation of the interest, rather than the time at which the interest vested, or became possessory. Thus, for example, where property is transferred to X for life, remainder to Y, both X and Y were required to disclaim within a reasonable time of the original transfer, although Y could not take possession of the property until X's death.

These regulations also applied to interests created by transfers made prior to November 15, 1958. Thus, under the regulations, a disclaimer of an interest created by a transfer made prior to November 15, 1958, would be qualified for Federal transfer tax purposes only if it were made within a reasonable time after the original transfer creating the interest. This position was upheld by the Supreme Court in *Jewett v. Commissioner*, 102 S.Ct. 1082 (1982).

In the Tax Reform Act of 1976, Congress adopted a set of uniform rules to govern disclaimers of property interests transferred before December 31, 1976 (sec. 2518). Under that section, a disclaimer generally is effective for Federal estate and gift tax purposes if it is an irrevocable and unqualified refusal to accept an interest in property and meets four other conditions. First, the refusal must be in writing. Second, the written refusal generally must be received by the person transferring the interest, or the transferor's legal representative no later than nine months after the transfer creating the interest.<sup>8</sup> Third, the disclaiming person must not have accepted the interest or any of its benefits before making the disclaimer. Fourth, the interest must pass to a person other than the person making the disclaimer or to the decedent's surviving spouse as a result of the refusal to accept the interest.<sup>9</sup>

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<sup>8</sup> However, the period for making the disclaimer is not to expire until nine months after the date on which the person making the disclaimer has attained age 21.

<sup>9</sup> In addition, with respect to interests created after December 31, 1981, certain transfers to the person or persons who would have otherwise received the property if an effective disclaimer had been made under local law, may be treated as qualified disclaimers, provided the transfer is timely made and the transferor has not accepted the interest or any of its benefits.

### *Explanation of Proposal*

No gift would occur by reason of a disclaimer made with respect to any of four specific property interests created prior to 1942 if the disclaimer is made within a specified period after the disclaimant's interest vests.

#### *Effective Date*

The proposal would be effective for claims for refund made within one year of the date of enactment.

### **3. Annual exclusion for gift tax and definition of a present interest**

#### *Present Law*

The first \$10,000 of gifts of present interests to each donee during any one calendar year are excluded from Federal gift tax. Several courts have held that a power to withdraw annual contributions to a trust during the year of contribution gives the holder of that power a present interest in the contributions, even if another person actually receives the property. *See, e.g., Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968). This result has been upheld even when the power is of short duration.

### *Explanation of Proposals*

#### *Proposal 1*

A donor would be limited to a total of \$30,000 of excluded gifts per year. As under present law, the maximum excluded gift for each donee would be \$10,000 per year.

#### *Proposal 2*

A gift of property in trust would be treated as a gift of a future interest unless the donee's power of withdrawal lasts for his life.

#### *Effective Date*

The proposal would be effective for gifts made after the date of committee action.

### **4. Cap on State death tax credit**

#### *Present Law*

A gift tax is imposed on transfers by gift during life, and an estate tax is imposed on transfers at death. The Federal estate and gift taxes are unified, so that a single progressive rate schedule is applied to an individual's cumulative lifetime and testamentary transfers. For decedents dying prior to 1993, the estate and gift tax rates begin at 18 percent on the first \$10,000 of taxable transfers and reach 55 percent on taxable transfers over \$3 million. After 1993, the top rate drops to 50 percent on transfers over \$2.5 million.

A dollar-for-dollar credit is allowed against the Federal estate tax for any estate, inheritance, legacy, or successions taxes paid to

a State with respect to any property included in the gross estate. The maximum amount of the credit varies with the size of the adjusted taxable estate. The maximum credit begins at 0.8 of 1 percent for transfers of less than \$90,000, increases to 8.8 percent for transfers of \$3 million, and reaches 16 percent for transfers exceeding \$10 million.

### *Explanation of Proposal*

Under the proposal, the increase in the State death tax credit would cease at the amount at which the highest Federal estate tax bracket is reached. Thus, for decedents dying prior to 1993, the credit would be capped at 8.8 percent.

### *Effective Date*

The proposal would be effective for decedents dying after the date of enactment.

## G. Other Proposals

### 1. Treatment of gain from the sale or exchange of property that effectuates the policy of the Federal Communications Commission

#### *Present Law*

If the Federal Communications Commission ("FCC") certifies that a sale or exchange of property is necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the FCC with respect to the ownership and control of broadcasting stations, a taxpayer may elect to treat the sale or exchange as an involuntary conversion within the meaning of section 1033. Under section 1033, gain realized by a taxpayer from the involuntary conversion of property is not recognized to the extent that the taxpayer purchases property that is similar or related in service or use to the converted property.

Unlike section 1033, however, in the case of a sale certified by the FCC, stock of a corporation operating a radio broadcasting station is treated as property that is similar or related in service or use to the converted property, whether or not the stock represents control of the corporation. In addition, in the case of a sale certified by the FCC, a taxpayer may elect to defer the recognition of gain that would otherwise be recognized under section 1033 (e.g., due to the failure to purchase property that is similar or related in service or use to the converted property) if the basis of depreciable property that is owned by the taxpayer immediately after the sale or that is acquired during the same taxable year is reduced by the amount of the deferred gain.

#### *Explanation of Proposal*

A taxpayer would be allowed to elect to defer the recognition of gain that is realized upon the sale of a radio or television broadcasting station (or stock in a corporation that owns a radio or television broadcasting station) if (1) within two years of such sale, the taxpayer purchases an interest in an international communications satellite system or an interest in an entity that owns or operates an international communications satellite system and (2) the taxpayer reduces the basis of depreciable property that is owned by the taxpayer immediately after the sale or that is acquired by the taxpayer within two years of the sale by the amount of the deferred gain. For this purpose, an interest in an international communications satellite system or an interest in an entity that owns or operates an international communications satellite system would be considered depreciable property that is eligible for the basis reduction election.

### *Effective Date*

The proposal would apply to sales that occur on or after January 1, 1986.

## 2. Contributions in aid of construction of regulated water utilities

### *Present Law*

Contributions in aid of construction received by a public utility are treated as gross income of the utility and not as contributions to the capital of the utility. Consequently, a utility is required to include in gross income the value of any property (including money) that it receives to provide, or to encourage it to provide, services to, or for the benefit of, any person transferring property to the utility. A utility is considered as having received property to encourage the provision of services if the receipt of the property is a prerequisite to the provision of services, if the receipt of the property results in the provision of services earlier than would have been the case had the property not been received, or if the receipt of the property otherwise causes the transferor to be favored in any manner.

### *Explanation of Proposal*

A contribution of money or other property by any person to a regulated public utility that provides water services would be treated as a contribution to capital and not as an item of gross income if the contribution is a contribution in aid of construction. This treatment would apply only if the contribution (or any property acquired or constructed with the contribution) is not included in the utility's rate base for ratemaking purposes. If the contribution is in the form of cash or property other than a water facility, such contribution would be treated as a contribution to capital if the amount of the contribution is expended for the acquisition or construction of tangible property used in the trade or business of furnishing water services and the expenditure occurs before the end of the second taxable year after the year in which the contribution is received.

No deduction or credit would be allowed with respect to any expenditure that constitutes a contribution to capital under the provision and the adjusted basis of any property acquired by such an expenditure would be zero. Finally, the Treasury Department would be directed to issue regulations that define the term contribution in aid of construction, but in no event would such term include amounts paid as customer connection fees.

### *Effective Date*

The proposal would be effective for contributions received after the date of enactment.

### 3. Treatment of nuclear decommissioning funds

#### *Present Law*

An eligible taxpayer that is required to decommission a nuclear power plant may elect to deduct certain contributions that are made to a nuclear decommissioning fund. A nuclear decommissioning fund is a segregated fund the assets of which are to be used exclusively to pay nuclear decommissioning costs, taxes on fund income, and certain administrative costs. The assets of a nuclear decommissioning fund that are not currently required for these purposes must be invested directly in (1) public debt securities of the United States, (2) obligations of a State or local government that are not in default as to principal or interest, or (3) time or demand deposits in a bank or an insured credit union located in the United States. The income of a nuclear decommissioning fund is subject to tax at a rate equal to the maximum rate of tax that applies to corporations (currently 34 percent).

#### *Explanation of Proposal*

The rate of tax imposed on the income of a nuclear decommissioning fund would be reduced from 34 percent to 15 percent. In addition, the investment restrictions applicable to nuclear decommissioning funds would be repealed.

#### *Effective Date*

The proposal would apply to taxable years beginning after December 31, 1988.

### 4. Treatment of tuxedos held for rental

#### *Present Law*

Tuxedos held for rental are assigned a class life of 9 years under the accelerated cost recovery system as modified by the Tax Reform Act of 1986. Consequently, for regular tax purpose, the depreciation deduction for rental tuxedos generally is determined by using a 5-year recovery period, the applicable convention, and the 200-percent declining balance method switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

#### *Explanation of Proposal*

Tuxedos held for rental would be assigned a class life of 2 years. Consequently, for regular tax purposes, the depreciation deduction for rental tuxedos would be determined by using a 3-year recovery period, the applicable convention, and the 200-percent declining balance method switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized. Alternatively, a taxpayer would be allowed to elect under the alternative depreciation system to determine the depreciation deduction for rental tuxedos by using a 2-year recovery period, the applicable convention, and the straight-line method.

### *Effective Date*

The proposal would apply to rental tuxedos placed in service after December 31, 1989.

## **5. Treatment of interest on indebtedness with respect to certain life insurance contracts**

### *Present Law*

Present law limits the deductibility of interest paid or accrued on indebtedness with respect to life insurance contracts that are owned by a taxpayer and that cover the life of an officer or employee of, or an individual financially interested in, a trade or business carried on by the taxpayer. Under the limitation, a taxpayer may not deduct interest to the extent attributable to the amount by which the aggregate amount of indebtedness of the taxpayer with respect to insurance contracts that cover each officer, employee, or financially interested individual exceeds \$50,000.

### *Explanation of Proposal*

In addition to the limitation of present law, a deduction would be allowed for interest paid or accrued on indebtedness with respect to life insurance contracts that cover the life of an officer, employee, or financially interested individual, only if the officer, employee, or financially interested individual is irrevocably designated as the insured and the entire death benefit under the contract is payable (directly or indirectly through a trust or the insured's estate) to an individual who is a member of the insured's family (as defined in section 267(c)(4)). The proposal and the present-law limitation also would be extended to interest on indebtedness with respect to life insurance contracts that cover directors, retired employees, and other similar individuals.

### *Effective Date*

The proposal would apply to contracts that are entered into or that are exchanged on or after the date of committee action.

## **6. Treatment of gain or loss on sale of assets by cooperative associations**

### *Present Law*

#### *In general*

A cooperative association is a corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with, or for, such patrons (Code sec. 1381). Unlike other corporations, a cooperative association may exclude from its taxable income any patronage dividends paid to its members or patrons or in redemption of a nonqualified written notice of allocation (sec. 1382). Additionally, cooperative associations may exclude income attributable to qualified per-unit retain certificates and amounts paid for redemptions of nonqualified per-unit retain certificates. A per-unit retain allocation is, in general, an amount re-

tained by the cooperative association with respect to goods marketed by the association for the patron.

### *Treatment of patronage dividends by members and patrons*

Members of a cooperative association who receive patronage dividends must treat the dividends consistently with the transaction giving rise to the dividend. For example, patronage dividends attributable to the marketing of a product to a member are treated like additional proceeds from the sale of the product and are includible in the recipient's income. Likewise, patronage dividends attributable to the purchase of equipment for its members are treated as a reduction in the recipient's basis in the purchased equipment (provided the recipient still owns the equipment).

### *Definition of patronage dividend*

In general, a patronage dividend is an amount paid to a patron (1) on the basis of the quantity or value of business done with or for such patron, (2) under a preexisting obligation of the cooperative association to pay such amount, and (3) which is determined by reference to the net earnings of the organization from business done with or for its patrons. "Such term does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions." (sec. 1388(a)).

### *Definition of income derived from sources other than patronage*

The Treasury regulations provide that "income derived from sources other than patronage" means incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment in securities, or from the sale or exchange of capital assets, constitutes income derived from sources other than patronage." Treas. Reg. sec. 1.1382-3(c)(2).

Notwithstanding the language of the Treasury regulations, both the Internal Revenue Service and the courts have held that other types of income may constitute income derived from patronage sources. See, for example, *Land O'Lakes, Inc. v. United States*, 675 F. 2d 988 (8th Cir. 1982) (dividends from stock in bank whose purchase was necessary to receive financing for patronage activities held to be patronage source income); *Astoria Plywood Corporation v. United States*, 79-1 U.S.T.C. par. 9197 (D. Ore. 1979) (income received from cancellation of a lease on a building used by cooperative for patronage-sourced activities was patronage source income); *Linnton Plywood v. United States*, 410 F. Supp. 1100 (D. Ore. 1976) (dividends received from a subsidiary corporation that made glue for the parent cooperative's plywood operation held to be patronage source income); *St. Louis Bank for Cooperatives v. United States*, 624 F. 2d 1041 (Ct. Cl. 1980) (interest earned on short-term investment of temporary excess cash of a cooperative bank held to be patronage source income); Rev. Rul. 69-576, 1969-2 C.B. 166 (patronage

dividend from cooperative bank on loans used for patronage business considered patronage source income because it "facilitates the accomplishment of the cooperative's marketing, purchasing, or service activities ...").

The Internal Revenue Service has ruled that any gain treated as ordinary income under the depreciation recapture rules of section 1245 is allocated to patronage source income in accordance with the method of allocation utilized in prior years in which the depreciation deductions were taken. *See* Rev. Rul. 74-84, 1974-1 C.B. 244. The ruling further held that any additional gain which is treated as capital gain is not patronage-sourced income. Notwithstanding the position of the Internal Revenue Service, the law remains unclear where the cooperative association has a gain from the sale of property.

### *Explanation of Proposal*<sup>10</sup>

A cooperative would be allowed to elect to treat gain or loss on the sale or other disposition of certain assets as ordinary income or loss and to include such gain or loss in the determination of net earnings done with or for patrons. The election could be made for any asset (including stock or any other ownership or financial interest in another entity) to the extent the asset was used to facilitate the conduct of business done with, or for, its patrons. For these purposes, the extent of use would be determined under any reasonable method for allocating income and expense between patronage and nonpatronage operations.

The election would apply in the taxable year in which made and for all succeeding years, unless revoked by the cooperative. If the cooperative revokes its election, it may not again make the election for the two succeeding years.

### *Effective Date*

In general, the proposal would be effective for taxable years ending after the date of enactment. In addition, the proposal would apply to all taxable years beginning on or before the date of enactment, if the taxpayer so elects on its return for its first taxable year ending after such date.

## **7. Sports facility bonds**

### *Present Law*

Interest on State and local government bonds generally is exempt from Federal income tax (Code sec. 103). Interest on private activity bonds issued by such governments is taxable unless a specific exemption is provided in the Internal Revenue Code. In addition, the availability of certain private activity tax-exempt bond financing is limited by a State annual private activity volume limitation. Specifically, the volume limitation applies to (1) exempt-facility bonds (other than bonds for airports, docks and wharves, and certain governmentally owned solid waste disposal facilities), (2) qualified mortgage bonds, (3) qualified small-issue bonds, (4) quali-

<sup>10</sup> The proposal is the same as H.R. 2353, except for the effective date.

fied student loan bonds, and (5) qualified redevelopment bonds. Certain other private activity bonds for which tax-exemption specifically is provided in non-Code provisions also are subject to the new private activity bond volume limitations. While sports stadiums and convention facilities could have been financed as qualified exempt facilities prior to the Tax Reform Act of 1986, they no longer fall within any category of exempt-facility bonds eligible for tax exemption under present law.

The Tax Reform Act of 1986 provided transition relief for specific bond-financed facilities including sports stadiums and convention facilities which would be placed in service after 1986. The State annual private activity bond limitation applies to bonds issued under the transitional relief. The Tax Reform Act of 1986 generally provided that such bonds must be issued before January 1, 1991, to qualify for transition relief.

In particular, the Tax Reform Act of 1986 provided transition relief for \$50 million of bonds for a baseball stadium and adjacent parking facility for the city of San Francisco and for \$75 million of bonds for meeting rooms for a convention center for the city of San Francisco (secs. 1317(3)(R) and (7)(E) of the Tax Reform Act of 1986).

### *Explanation of Proposal*

The proposal would permit the transfer of \$75 million of bond authority for use in financing construction of meeting rooms for a convention center for the city of San Francisco to use in financing a baseball stadium and adjacent parking facilities for the city of San Francisco. In the aggregate, the proposal would permit the issuance of \$125 million of bonds to finance the construction of a baseball stadium and adjacent parking facilities for the city of San Francisco. The proposal would extend the deadline for issuing such bonds to June 30, 1992. The proposal also would provide that bonds issued under the proposal are not subject to the State annual private activity bond limitation.

### *Effective Date*

The proposal would be effective upon the date of enactment.

## **8. Treatment of income from personal injury awards for minor children**

### *Present Law*

As a result of the Tax Reform Act of 1986, the unearned income of a child under age 14 generally is taxed at the top marginal rate of his or her parents.

### *Explanation of Proposal*

Income attributable to lump sum damages awarded to a child before the effective date of the 1986 Act would be taxed at the child's rate if such income accrues in a custodial account and is prohibited from being used to satisfy an obligation of support.

### *Effective Date*

The proposal would be effective for taxable years beginning after December 31, 1986.

## **9. Deductibility of fees for "New Communities Act" associations**

### *Present Law*

Taxpayers who itemize deductions are allowed a deduction for State and local real property and personal property taxes paid or accrued within the taxable year (sec. 164(a)). A State or local tax includes only a tax imposed by a State, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia (sec. 164(b)).

Section 262 provides a general rule that, except as otherwise provided in the Code, no deduction shall be allowed for personal, living, or family expenses.

The Urban Growth and New Community Development Act of 1970, (42 U.S.C. secs. 4511-4532) grants authority to the Secretary of Housing and Urban Development (HUD) to provide various forms of financial assistance (e.g., guarantees, loans, and supplementary grants) to "new community development programs," meaning programs which are intended to result in a newly built community (or a major addition to an existing community) and determined by the Secretary of HUD to provide an alternative to disorderly urban growth and to meet certain other criteria. A new community development program approved for assistance under the Act may be undertaken by a private developer or a State land development agency approved by the Secretary of HUD (42 U.S.C. sec. 4513(b)).

### *Explanation of Proposal*

The proposal would allow an itemized deduction under section 164 for annual assessments paid to community associations which are authorized to receive financial assistance under the Urban Growth and New Community Act of 1970. Such assessments would be deductible only if used to provide municipal-type services and if uniformly imposed throughout the community.

### *Effective Date*

The proposal would be effective after December 31, 1990.

## **10. Tax treatment of public transit and van pool benefits**

### *Present Law*

Under present law, gross income does not include a fringe benefit that qualifies as a de minimis fringe (sec. 132). In general, a de minimis fringe is any property or service the value of which (after taking into account the frequency with which similar fringe benefits are provided by the employer to the employer's employees) is so small as to make accounting for it unreasonable or administratively impracticable. Employer-provided transit passes, tokens, fare cards, and reimbursements for such items are considered a de minimis fringe if the employer-provided value of the benefit does not

exceed \$15 per month. This exclusion does not apply to the provision of any benefit to defray public transit expenses incurred for personal travel other than commuting. If the benefit exceeds \$15 per month, then the total value of the benefit is includible in income.

Under prior law, certain employer-provided transportation ("van pooling") between an employee's residence and place of work was excludable from gross income. In order to be eligible for the exclusion, the transportation was required to be provided in a commuter highway vehicle and under a separate written plan of the employer that was not discriminatory in favor of officers, shareholders, or highly compensated employees. In addition, the plan was required to provide that the benefit was in addition to (and not in lieu of) any compensation otherwise payable to the employee. This exclusion expired for taxable years beginning after December 31, 1985.

### *Explanation of Proposal*

Under the proposal, up to \$15 per month of the value of transit passes, tokens, etc., provided or subsidized by the employer for commuting expenses would be excludable from income, regardless of the total value of the benefit.

The proposal would also reinstate the prior-law exclusion for vanpooling.

### *Effective Date*

The proposal would be effective for taxable years beginning after December 31, 1990.

## **11. Deductibility of student loan interest**

### *Present Law*

Under present law, 10 percent of personal interest is deductible in taxable years beginning in 1990, and personal interest is not deductible for taxable years beginning in 1991 and thereafter. Qualified residence interest is not subject to the limitation on the deduction for personal interest. Qualified residence interest is interest on debt used to acquire, construct, or substantially improve the taxpayer's principal or second residence (up to a total debt of \$1 million). Qualified residence interest also includes interest on up to \$100,000 of other debt secured by the taxpayer's principal or second residence ("home equity loans").

### *Explanation of Proposal*

Under the proposal, interest on debt incurred to pay certain tuition, fees and reasonable living expenses while away from home, of the taxpayer, his spouse or a dependent for attendance at an educational institution described in Code section 170(b)(1)(A)(ii) would be deductible.

### *Effective Date*

The proposal would be effective for taxable years beginning after December 31, 1990.

## 12. Deductibility of certain flight-training expenses

### *Present Law*

Under prior law, eligible veterans who attended flight-training courses could receive educational assistance allowances from the Veterans' Administration of up to 90 percent of the costs incurred by the veteran (38 U.S.C. sec. 1677). These reimbursements were excludable from the income of the veteran. The education assistance allowances were repealed in 1981 (Public Law 97-35, sec. 2003). Certain taxpayers both excluded the allowance from their income and deducted the full cost of attending the flight-training course based on their belief that the course either maintained or improved skills required for their trade or business. The Internal Revenue Service took the position that no deduction was allowed to the extent that the expenses had been reimbursed by the Veterans' Administration.<sup>11</sup>

### *Explanation of Proposal*

Under the proposal, for taxable years before 1980, the deductibility of flight-training expenses would be determined without regard to whether such expenses were reimbursed through veterans educational assistance allowances. In addition, the proposal would allow a taxpayer to file a claim for a refund or credit of taxes that were overpaid as a result of the proposal if the claim is filed prior to the close of the 1-year period beginning on the date the proposal is enacted. This 1-year period for making the claim for refund would apply without regard to whether the taxpayer is otherwise barred (for example, by the expiration of the statute of limitations) from receiving a refund or credit.

### *Effective Date*

The proposal would be effective upon the date of enactment.

## 13. Extend eligibility for the earned income tax credit to military personnel stationed overseas

### *Present Law*

Eligible low-income workers are permitted to claim a refundable earned income tax credit (EITC) of up to 14 percent of the first \$6810 of earned income for 1990. The maximum amount of credit for 1990 is \$953, and this maximum is reduced by 10 percent of earned income in excess of \$10,730. The EITC is not available for workers with earned income over \$20,264. Earned income consists of wages, salaries, other employee compensation (including certain allowances provided to military personnel), and net self-employment income.

<sup>11</sup> See, Rev. Rul. 80-173, 1980-2 CB 60, distinguishing and clarifying Rev. Rul. 62-213, 1962-2 CB 59. The position of the IRS was upheld in *Manocchio v. Comm.*, 710 F.2d 1400 (9th Cir. 1983), *Olszenski v. Comm.*, 55 AFTR 2d 85-536 (1st Cir. 1985), and several Tax Court cases; the position of the IRS was determined to be arbitrary in *Baker v. United States*, 748 F.2d 1465 (11th Cir. 1984).

To be eligible for the EITC, the taxpayer must be classified for income tax purposes as either married, a surviving spouse, or a head of household. In addition, the taxpayer must have a child residing in the taxpayer's household for at least half of the taxable year. Under present law, this household must be located in the United States.

### *Explanation of Proposal*

Under the proposal, eligibility for the EITC would be extended to military personnel stationed overseas. For purposes of determining eligibility for the EITC, a member of the military stationed outside the United States on extended active duty would be considered as maintaining a household in the United States.

In addition, the proposal would value basic allowances for housing and subsistence (provided by the military) as earned income for purposes of computing the EITC and information regarding these valuations would be provided to military personnel. This increased information flow to military personnel would allow persons claiming the EITC to more accurately determine the actual amount of their earned income.

### *Effective Date*

The proposal would apply to taxable years beginning after December 31, 1990.

## **14. Additional low-income housing tax credit allocation**

### *Present Law*

A tax credit is allowed in annual installments over 10 years for qualifying low-income rental housing, which may be newly constructed or substantially rehabilitated residential rental property. For most newly constructed and rehabilitated housing placed in service after 1987, the credit percentages are established at a level sufficient to create a credit stream with a present value of 70 percent of the total qualified expenditures. In the case of housing receiving other Federal subsidies (including tax-exempt bonds), the present value of the credit stream may not exceed 30-percent of the total qualified expenditures. Generally, that part of the building for which the credit is claimed must be rented to low-income tenants at restricted rents for 15 years after the building is placed in service. In addition, for buildings placed in service after December 31, 1989, a 30 year extended-use low-income tenant compliance period is required.

In order for a building to be a qualified low-income building, the building owner generally must receive a credit allocation from the appropriate credit authority. An exception is provided for property which is substantially financed with the proceeds of tax-exempt bonds subject to the State's private-activity bond volume limitation. The low-income housing credit is allocated by State or local government authorities subject to an annual limitation for each State. The annual credit allocation was \$1.25 per resident for years before 1990 and is \$0.9375 per resident for 1990.

*Explanation of Proposal*

The proposal would allocate a specific housing credit dollar amount to certain projects for 1990. To qualify for the allocation, the transfer of a qualified existing building must have been subject to approval of the Department of Housing and Urban Development. Further, an application for approval must have been submitted, but not granted, as of December 31, 1989. To qualify for this allocation, among other requirements, the taxpayer must have manifested an intention to work with the tenant association of the project to develop a plan of tenant participation.

*Effective Date*

The proposal would be effective upon the date of enactment.



