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H.R. 699 (Messrs. Stark and Archer)
Tax Treatment of Certain Conversions of Residential Rental Property Into Condominium Units

Present Law

Under present law, gain on the sale of undivided residential rental property, held by a taxpayer as an investment, is generally treated as capital gain. If, however, the taxpayer converts the rental property into condominium units and sells the individual units, the entire gain is generally treated as ordinary income; because of the conversion of the property to condominium units and the subsequent sales activity, the taxpayer is treated as a dealer rather than an investor in the property. As a result, owners of residential rental property who wish to convert it into condominiums often sell the property to another person who converts the property and sells the individual units.

Explanation of Bill

The bill would provide that a taxpayer could elect to treat the conversion of qualified residential rental property into condominium units as a sale at the time of conversion for purposes of determining the proportion of the gain recognized from the sale of the individual units that is treated as capital gain. The amount of the gain determined at the time of the conversion would be treated as capital gain when the gain from the sale is recognized under present law; any additional gain on the disposition of the units would be treated as ordinary income at such time. In order to determine the amount of the gain at the time of conversion, the property would be treated as having been sold for an amount equal to its fair market value, as residential rental property, immediately before the conversion. Capital expenditures after the date of conversion reduce the portion of the gain treated as ordinary income.

Effective Date

The bill would apply to conversions after the date of enactment in taxable years ending after such date.

Revenue Effect

The provisions of the bill are estimated to reduce fiscal year budget receipts by $74 million in 1984; $75 million in 1985; $35 million in 1986; $2 million in 1987; and to increase fiscal year budget receipts by $26 million in 1988.

Possible Modifications

1. The bill could be modified so that it is applied only where residential property is converted into condominiums that were primarily used for residential purposes.

2. The bill could be clarified as to when the conversion takes place by providing that the conversion occurs at the earlier of the date of the adoption of a plan of conversion, the date any substantial improvements are made to the property in anticipation of the conversion, or the date the ownership of the property is changed into condominium units.

3. The bill could be modified to clarify that in determining the portion of the sales price of any condominium unit which will be treated as capital gain, the total capital gain deemed realized on the conversion date must be allocated among all the units of the property on that date according to their fair market value. Any additional gain realized on the ultimate sale of each such unit would be ordinary income.

4. The bill could be modified to provide that all or a portion of the capital gain treatment could be denied if the property were significantly overvalued. For example, capital gain treatment could be denied if the property were overvalued by more than 20% and a pro rata portion would be denied if the overvaluation were more than 15% but less than 20%.

5. The bill could be modified to insure that results more generous that those provided under the bill can not be achieved through the use of collapsible corporations.

H.R. 2476 (Messrs. Duncan, Boner, and Skelton)
No Gain Recognized from any Net Gift Made Before March 4, 1981

Present Law

Present law taxes income "from whatever source derived," including the benefit resulting from the discharge of one's indebtedness by another party (Code sec. 61(a)(12)). Present law also imposes a gift tax on certain transfers for less than adequate consideration (sec. 2501). Liability for the gift tax is on the donor of the transferred property.

A donor may transfer property pursuant to an agreement with the donee that the donee will pay any gift tax arising from the transfer (i.e., make a "net gift"). On June 15, 1982, the U.S. Supreme Court, affirming a decision of the U.S. Court of Appeals for the Eighth Circuit, ruled in Diedrich v. Commissioner, that the discharge of a donor's liability for gift tax by the donee of a net gift gives rise to income to the donor to the extent that the gift taxes exceeded the donor's adjusted basis in the transferred property.

Explanation of the Bill

The bill would provide that no income would be recognized to donors who made net gifts before March 4, 1981 (the date on which an initial decision by the Court of Appeals held that the donor in the Diedrich case recognized income).

Revenue Effect

It is estimated that the bill would reduce budget receipts by less than $5 million.

H.R. 2504 (Messrs. Schulze and Murtha)
Exemption of Interest on Obligations Issued by Certain Educational Organizations

Present Law

Interest on State and local government obligations generally is exempt from Federal income tax.

Treasury regulations provide that State and local obligations include obligations issued by or on behalf of a State or local governmental unit by authorities empowered to issue such obligations. The courts have held that whether an obligation has been issued by or on behalf of a State or local government unit depends on a variety of factors, including the degree of sovereign power exercised by the issuing authority and the relationship of the authority to the State or local government.

Explanation of the Bill

The bill would provide a tax exemption for the interest on obligations of a college or university created by act of the State legislature and for which the State has regularly made appropriations under the Morrill Act of 1862, which established Federal land-grant colleges. The exemption would apply regardless of whether the obligations were considered to have been issued by or on behalf of a State or local governmental unit. The bill would apply generally to obligations issued after the date of enactment.[1]

It is understood that the intended beneficiary of the bill is the Pennsylvania State University. However, any educational organization that meets the requirements of the bill would qualify to issue tax-exempt obligations.

Revenue Effect

Assuming that the bill benefits only Penn State, the revenue loss is estimated to be less than $10 million per year.

Possible Modification

Technical amendment to ensure that Penn State is the only beneficiary.

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[1] Interest on obligations issued after December 31, 1953, would be exempt from tax if the organization received, after that date, a Treasury ruling allowing such exemption.

H.R. 2831 (Mr. Panetta)
Disaster Loss Deduction for Residential Losses from Mudslides, Earthslides, or Flooding

Present Law

Present law allows a deduction for nonbusiness casualty losses to the extent such losses exceed 10 percent of adjusted gross income. In general, a deduction is allowed only when the casualty (e.g., storm, flood or earthquake) causes actual physical damage to the taxpayer's property.

Explanation of the Bill

The bill would provide that a taxpayer whose residence is located in a federally declared disaster area, and who is ordered by a State or local government to demolish or relocate the residence because of a danger of mudslides, earthslides, or flooding, may deduct a loss attributable to the demolition or evacuation order as a casualty loss.

Effective Date

The bill would apply to taxable years beginning after December 31, 1981, with respect to areas determined after that date to warrant Federal disaster assistance.

Revenue Effect

The provisions of the bill are estimated to reduce fiscal year budget receipts by $15 million in 1984; $12 million in 1985; $12 million in 1986; $13 million in 1987; and $13 million in 1988.

Possible Modification

1. The bill could require that the residence must be rendered unsafe for use as a residence by reason of mudslide, earthslide or flooding (or the threat thereof) which results from the disaster.

2. The bill could be extended to earthquakes.

H.R. 3096 (Mr. Stark)
Offshore Commodity Funds and Straddles

Present Law

Offshore commodity funds.--Taxpayers contend that a foreign corporation that is widely held by U.S. persons may establish a subsidiary to invest in U.S. commodities market without any of the parties incurring U.S. tax. They also contend that when the U.S. shareholders eventually dispose of their shares in the foreign corporation they will be subject to tax at only the capital gains rate.

Corporations formed to straddle.--Taxpayers may attempt to avoid the tax straddle rules by forming or using foreign corporations to take positions to offset their own.

Explanation of the Bill

Offshore commodity funds.--The bill would apply the accumulated earnings tax to certain earnings from U.S. investments, even after those earnings pass through corporate solution as dividends. The accumulated earnings tax would apply to a foreign corporation (half or more of whose voting shares are owned by U.S. persons) that receives a dividend from another foreign corporation if more than 10 percent of the paying corporation's earnings and profits were from U.S. sources or a U.S. business. This treatment would apply to distributions received by the foreign corporation on or after May 23, 1983. The bill would also generally treat gains of U.S. shareholders from sales or exchanges of stock in foreign commodity-trading corporations (half or more of whose voting shares are owned by U.S. persons) on or after May 23, 1983, as ordinary income.

Corporations formed to straddle.--The bill would treat stock ownership in a corporation formed or availed of to avoid the straddle rules as a position for the purposes of those rules. This treatment would prevent a taxpayer from recognizing losses when the taxpayer uses a corporation for straddling purposes. It would apply to positions established on or after May 23, 1983.

Revenue Effect

It is estimated that the bill would increase budget receipts by $10 million annually.

Possible Modifications

Offshore commodity funds.--(1) The accumulated earnings tax provisions of the bill could apply to interest as well as dividends. (2) A transition rule could provide that the provison will not apply to dispositions of stock held by the taxpayer on May 23, 1983, if the disposition occurs by May 23, 1985.

H.R. 3173 (Mr. Matsui) - Extension of Cash and Deferred Plan Rules to Salary Reduction Arrangements under Money Purchase Pension Plans

Present Law

The Employee Retirement Income Security Act of 1974 (ERISA) provided that amounts deferred by an employee under a cash or deferred arrangement or a salary reduction arrangement under a tax-qualified profit-sharing, stock bonus, or money purchase pension plan are excluded from the employee's gross income if (1) the plan was in existence on June 27, 1974, and (2) the applicable requirements of prior law were satisfied. Under the Revenue Act of 1978, specific rules were provided for cash or deferred profit-sharing or stock bonus plans. No rules were provided, however, for salary reduction arrangements under money purchase pension plans.

Explanation of the Bill

Amounts deferred by an employee pursuant to a salary reduction arrangement under a money purchase pension plan would be excluded from the employee's gross income if the plan was in existence on June 27, 1974, and contributions by employees and the employer do not exceed the levels permitted under the plan's contribution formula on that date. In addition, the plan must satisfy rules added by the 1978 Revenue Act with respect to employee participation and to prohibited discrimination in favor of officers, shareholders, or highly compensated employees.

The bill would apply retroactively for plan years beginning after 1980, and to contributions made after that date.

Revenue Effect

It is estimated that the bill would have a negligible effect on budget receipts.

H.R. 3592 (Messrs. Rostenkowski and Conable) - Rollover of Certain Partial Distributions from Qualified Plans, and for Other Purposes

a. Rollover of certain partial distributions from qualified, etc. plans

Present Law

If the balance to the credit of an employee is paid within one taxable year to the employee or to the surviving spouse of the employee from a qualified pension, profit-sharing, or stock bonus plan or a qualified annuity plan, generally all or any portion of the distribution may be rolled over, within 60 days of the date of the distribution, to another qualified pension, etc., plan or an individual retirement account, annuity, or retirement bond (an IRA). All plans of the same type (pension, profit-sharing, or stock bonus) maintained by an employer are generally required to be aggregated to determine whether the balance to the credit of the employee has been paid.

If a rollover is made, tax is deferred on the portion of the distribution rolled over. No rollover is permitted for a plan distribution that is not a total distribution. Accordingly, a partial distribution from a plan may not be rolled over to an IRA. Similar rules apply to benefits under tax-sheltered annuity contracts.

Explanation of the Provision

A plan distribution of less than the balance to the credit of the employee could be rolled over, tax-free, by the employee (or the surviving spouse of the employee) to an IRA if (1) the distribution equals at least 50 percent of the balance to the credit of the employee under the plan, (2) the distribution is not one of a series of periodic payments, and (3) the employee (or surviving spouse) elects tax-free rollover treatment. If rollover treatment is elected, any subsequent distribution from the same plan (or any other plan of the employer required to be aggregated with the plan under the rules) would not be eligible for the special 10-year income averaging, capital gains, or net unrealized appreciation treatment provided for lump-sum distributions from qualified plans.

The provision would be effective for distributions made after December 31, 1983, in taxable years ending after that date.

Revenue Effect

It is estimated that the bill would have a negligible effect on budget receipts.

b. Treatment of certain transactions between related parties

Present Law

Under present law, an accrual-basis taxpayer, in order to obtain a deduction for business expenses or interest accrued to a cash-basis person related to the taxpayer, must ordinarily pay such items not later than 2-1/2 months after the close of its taxable year. In the case of a subchapter S corporation, payments owed to a related party cash-basis taxpayer, including a shareholder who owns at least 2 percent of the stock of the corporation, are deductible only when paid, whether or not paid after the expiration of the 2 1/2-month period. Also, present law denies losses on sales or exchanges of property between related parties.

Explanation of Provisions

The bill would amend the related party rules so that a taxpayer would generally be placed on the cash method of accounting for purposes of deducting business expenses and interest owed to a related party cash basis taxpayer. Also, the present law rules relating to payments by subchapter S corporations would be extended to payments by partnerships. Thus, an accrual basis partnership generally could not deduct unpaid amounts accrued to any cash basis partner (or person related to the partner) and any deduction for those amounts would be allowable only when paid.

Finally, the bill would extend the loss disallowance and accrual provisions to transactions between corporations which are members of a controlled group of corporations, using a 50-percent control test.

These provisions would apply to taxable years beginning after 1983.

Revenue Effect

It is estimated that the bill would increase budget receipts by less than $10 million annually.

Possible Modifications

1. A transitional rule could grandfather (a) interest on indebtedness incurred on or before July 19, 1983 (the date of introduction of H.R. 3592) or incurred pursuant to a contract binding on that date and all times thereafter and (b) business expenses made pursuant to a contract which was binding on July 19, 1983, and at all times thereafter.

2. The bill could clarify that the expense deferral provision would apply to all deductible expenses, regardless of the Code section under which the deduction is allowed.

3. The bill could treat a subchapter C corporation and a partnership as related persons if the same persons own more than 50 percent of each entity.

4. The bill could apply all of the related party provisions of the Code to commonly controlled corporations and commonly controlled partnerships.

5. The bill could apply the partnership accrual rules to amounts accrued to partnerships and amounts accrued on behalf of partnerships as well as amounts accrued directly by partnerships.

c. Preferred stock eligible for small business corporation stock treatment

Present Law

Under present law, a taxpayer is allowed to deduct, as an ordinary loss, up to $50,000 ($100,000 in the case of a joint return) of loss on the disposition of "section 1244 stock." Generally, "section 1244 stock" means certain common stock of a domestic small business corporation.

Explanation of Provisions

The bill, which would apply to stock issued after the date of enactment, would extend the definition of "section 1244 stock" to include preferred stock of qualified small business corporations.

Revenue Effect

It is estimated that the provision will reduce budget receipts by less than $5 million annually.

d. Coordination of certain amendments made by the Highway Revenue Act of 1982 and Public Law 97-473

Present Law

The Highway Revenue Act of 1982 added a provision relating to interest on certain tax-exempt obligations. Public Law 97-473 may have inadvertently repealed the section contained in the Highway Revenue Act.

Explanation of Provisions

The bill would clarify that the provision of the Highway Revenue Act was not repealed.

Revenue Effect

The provision would not affect revenues.

H.R. 3593 (Messrs. Stark and Conable)
Medical Care Deduction Allowed For
Lodging Away From Home

Present Law

Individuals who itemize deductions may deduct expenses paid during the taxable year, not reimbursed by insurance or otherwise, for medical care of the taxpayer, the taxpayer's spouse, or a dependent, to the extent that such expenses exceed five percent of adjusted gross income (Code sec. 213). The term medical care is defined in the statute to include amounts paid for: (1) the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body; (2) transportation primarily for and essential to such medical care; and (3) insurance covering medical care (sec. 213(d)).

Thus, under present law, the costs of transportation for purposes of obtaining medical care are deductible (see, e.g., Winderman v. Comm'r, 32 T.C. 1197 (1959) (Los Angeles taxpayer with medical problems allowed to deduct round-trip cost of traveling to New York City for annual physical with internist). However, meal and lodging expenses incurred in connection with "out-patient" medical treatment received while away from home are not deductible (secs. 213, 262; Treas. Reg. sec. 1.213-1(e)(1)(iv); Comm'r v. Bilder, 369 U.S. 499 (1962) (deduction disallowed for rental of apartment in Florida for New Jersey taxpayer and his family, where taxpayer suffering from atherosclerosis had been advised by heart specialist to spend winter season in warm climate).

Explanation of the Bill

Under the bill, the definition of medical care provided in Code section 213(d) would be broadened to include amounts paid for lodging while away from home under circumstances in which such lodging is primarily for and essential to medical care provided by a physician in (1) a licensed hospital or (2) a nationally or regionally recognized medical care facility. The deduction would not be allowed for amounts paid for lodging that is lavish or extravagant under the circumstances. Further, no deduction would be allowed if there is a significant element of personal pleasure, recreation, or vacation in the travel away from home.

Effective Date

The provisions of the bill apply to taxable years beginning after December 31, 1983.

Revenue Effect

The provisions of the bill are estimated to reduce fiscal year budget receipts by $1 million in 1984; $9 million in 1985; $10 million in 1986; $12 million in 1987; and $14 million in 1988.

Possible Modifications

The amount of deductible lodging costs could be subject to a per-diem limitation, such as the Federal Government per-diem allowance for Federal employees traveling away from home on government business.