SUMMARY DESCRIPTION OF
REVENUE RECONCILIATION PROVISIONS
FOR FINANCE COMMITTEE CONSIDERATION

Prepared for the

SENATE COMMITTEE ON FINANCE

By The Staff

of the

JOINT COMMITTEE ON TAXATION

October 16, 1987

JCX-17-87

CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a brief description of revenue reconciliation provisions to be considered by the Senate Committee on Finance on October 16, 1987.

The first part of the document describes the revenue-raising provisions for revenue reconciliation, including accounting provisions, estimated tax revisions, corporate tax provisions, estate and gift tax provisions, excise tax provisions, employment tax provisions, pension and PBGC provisions, user fees, and IRS refund offset authority. The second part describes certain miscellaneous tax provisions.

---

1 This document may be cited as follows: Joint Committee on Taxation, Summary Description of Revenue Reconciliation Provisions for Finance Committee Consideration (JCX-17-87), October 16, 1987.

I. REVENUE-RAISING PROVISIONS

A. Accounting Provisions

1. Repeal Completed Contract Method

Present Law

Taxpayers engaged in the production of property under a long-term contract must compute income from the contract under either the percentage of completion method or the percentage of completion-capitalized cost method. Under the percentage of completion method, income is reported based on the percentage of a contract completed during the year. Under the percentage of completion-capitalized cost method, 40 percent of a contract is reported under the percentage of completion method, and 60 percent under the completed contract method, under which income is reported in the year the contract is completed.

Certain small businesses may use the completed contract method fully with respect to contracts to be completed within two years.

Explanation of Provisions

The percentage of completion-capitalized cost method of accounting for long-term contracts would be repealed. Thus, the full amount of all long-term contracts (other than contracts of small businesses exempted under present law) would be reported on the (100 percent) percentage of completion method.

Effective Date

The provision would be effective for contracts entered into on or after the date of committee action.

2. Repeal of Vacation Pay Reserve

Present Law

Under present law, an accrual-method taxpayer generally is permitted a deduction in the taxable year in which all of the events have occurred that determine the fact of a liability and the amount thereof can be determined with reasonable accuracy. Nonetheless, in order to ensure the proper matching of income and deductions in the case of deferred benefits for employees (such as vacation pay earned in the current taxable year, but paid in a subsequent year), an employer generally is entitled to claim a deduction in the taxable year of the employer in which ends the taxable year of the employee in which the benefit is includible in gross income. Consequently, an employer generally is entitled to a deduction for vacation pay in the taxable year of the employee for which the pay (1) vests (if the vacation pay plan is funded by the employer) or (2) is paid and for amounts which vest or are paid within 2-1/2 months after the end of the employer's taxable year. Under a special rule, an employer can elect to deduct an amount representing a reasonable addition to a reserve account for vacation pay earned by employees before the close of the current year and paid by the close of that year or within 8-1/2 months thereafter.

Explanation of Provision

The special rule that permits taxpayers a deduction for additions to a reserve for vacation pay could be repealed. Under this proposal, deductions for vacation pay would be allowed in any taxable year for amounts paid, or funded amounts which vest, during the year or within 2-1/2 months after the end of the year.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

3. Installment Sales

Present Law

Under present law, a taxpayer who sells property ordinarily must recognize gain or loss at the time of the sale. However, a taxpayer who is eligible to use the installment method may defer the payment of tax and recognize gain from a sale of property in proportion to the payments received.

A taxpayer may not use the installment method for sales pursuant to a revolving credit plan and for sales of publicly traded property. In addition, the use of the installment method may be limited by the proportionate disallowance rule, which treats a portion of a taxpayer's indebtedness as payment on the installment obligations of the taxpayer. A taxpayer may elect to pay interest on the amount of deferred tax arising from the use of the installment method for certain sales of residential lots and "timeshares", rather than be subject to the proportionate disallowance rule.

The installment method may not be used for purposes of the alternative minimum tax if such method is not allowed for regular tax or in the case of sales that are subject to the proportionate disallowance rule.

Explanation of Provisions

1. Dealers.--The installment method would be repealed for all dealers effective for taxable years beginning after December 31, 1987. Taxpayers could elect to apply the rule retroactively to years beginning prior to December 31, 1987, in which case, the proportionate disallowance rule would not apply. The adjustment required by the change in accounting method would be includible in income over a period not to exceed four taxable years beginning with the year of change.

2. Nondealers.--A nondealer would generally be allowed to use the installment method; the proportionate disallowance rule would be repealed. The installment method would not be allowed for sales where the installment receivable is pledged as security or as part of a wraparound transaction. Such pledging would be treated as a payment on the installment obligation. However, a nondealer would be required to pay interest on the amount of deferred tax arising from the use of the installment method, to the extent that installment debt for the year exceeds $5 million. The present alternative minimum tax treatment of nondealer sales would not change.

The provision would be effective for sales after December 31, 1987. A taxpayer may elect to apply this rule to sales occurring between August 16, 1986 and January 1, 1988, in which case the proportionate disallowance rule would not apply to such sales.

3. Sellers of residential lots.--Sellers of residential lots (whether dealers or nondealers) could elect, as under present law, to retain the installment method by paying interest on the amount of tax deferred.

4. Amortization of Customer Base Intangibles

Present Law

No depreciation or amortization deductions are allowed with respect to property that is not a wasting asset or whose useful life cannot be estimated with reasonable accuracy. Such assets include goodwill and going concern value.

Taxpayers frequently take the position that a substantial portion of the purchase price of a business is allocable to assets that represent the value of the existing customer base and are said to have a determinable useful life as the customer base erodes. Evidence of continuing replacement of the customer base is often disregarded. In addition, the costs of such replacement are often not capitalized but are deducted currently. Such assets include, for example, customer and subscription lists; patient or other client records; the existing "core" deposits of banks; insurance in force in the case of an insurance company; advertising relationships and customer or circulation base in the case of a broadcast or newspaper business; other contracts or relationships reflecting the value of the customer base; and existing market share in the case of any business. Some taxpayers also deduct the cost of purchasing certain franchises or other assets with an indeterminate useful life, based on other interpretations of existing Code provisions, (i.e., a provision dealing with the treatment of certain lump-sum payments to a franchisor or trademark or trade name transferor who retains certain rights).

Explanation of Provision

The provision would clarify that amortization, depreciation or similar deductions are denied for intangible assets that are renewing or for any intangible assets with an indeterminate useful life. Deductions for intangible assets representing the value of the existing customer base or market share would be denied.

Effective Date

The provision would apply to acquisitions on or after the date of committee action, unless pursuant to a binding written contract in effect on that date and at all times thereafter.

B. Estimated Tax Provisions

1. Estimated Tax Penalty Relief for 1987

Present Law

Individuals

The 1986 Act increased from 80 to 90 percent the percentage of the current year's tax liability that must be paid in order to avoid an estimated tax penalty for taxable years beginning after December 31, 1986.

Corporations

Present law does not give explicit authority to the Treasury to provide alternative estimated tax rules for corporations.

The Treasury has issued regulations, applicable to estimated tax payments due before July 1, 1987, that permit corporations to base those estimated payments on 120 percent of 1986 taxable income with certain modifications.

Explanation of Provisions

Individuals

The increase in the required percentage of the current year's liability that must be paid as estimated taxes in order to avoid a penalty would be delayed for one year. In addition, employers would be required to make newly filed Forms W-4 effective on a more timely basis.

Corporations

Two safe harbors would be provided for estimated tax payments due before July 1, 1987. First, all corporations, including large corporations, would be permitted to base those estimated tax payments on 100 percent of the 1986 tax liability. Second, statutory authorization would be provided for the safe harbor provided in the Treasury regulations.

2. Corporate Estimated Tax Reform

Present Law

Under present law, a corporation that fails to pay an installment of estimated income tax on or before the due date generally is subject to a penalty computed at the rate of interest for tax underpayments. The penalty may not be waived. The penalty is computed by applying the underpayment interest rate to the amount of the underpayment of the installment for the period of the underpayment. The amount of the underpayment is the difference between the payments made on or before the due date of each installment and 90 percent of the total tax shown on the return for the year, divided by the number of installments that should have been made. The penalty on underpayments of estimated tax that are between 80 percent and 90 percent of the actual tax due is imposed at three-quarters of the full rate.

There are three exceptions to the penalty. No penalty is imposed upon a corporation if total tax payments for the year equal or exceed installments based on (1) the preceding year's tax liability, if a return showing a liability for tax was filed for the preceding year; (2) the tax computed by using the facts shown on the prior year's return under the current year's tax rates; or (3) 90 percent of the taxes which would be due if certain income already received during the current year was annualized. Large corporations may not use exceptions (1) and (2) described above. A large corporation is defined as a corporation having at least $1 million of taxable income in any of the three prior taxable years. No penalty is imposed where the tax is less than $40.

Explanation of Provisions

The provision would consolidate all the corporate estimated tax rules into one section of the Code, similar to the provision enacted for individuals in 1984. Also, several modifications would be made to present law.

The underpayment penalty with respect to any installment would apply to the difference between payments made by the due date of the installment and the lesser of an installment based on (1) 90 percent of the tax shown on the return; or (2) 100 percent of the tax shown on the preceding year's return. As under present law, exception (2) would generally not apply to a large corporation, except that a large corporation could use that exception for purposes of making its first estimated payment for any taxable year. In determining whether a corporation is a large corporation because its taxable income exceeds $1 million, net operating loss and capital loss carryforwards and carrybacks would be disregarded.

In addition, the full rate of the penalty would be imposed with respect to any payment only to the extent the total payments for the year up to the required installment are below 90 percent of the taxes which would be due if the income already received during the current year was placed on an annual basis. Any reduction in a payment resulting from using the annualization exception must be made up in the subsequent payment if the corporation does not use the annualization exception for that subsequent payment.

Finally, no penalty would be imposed if the tax for any taxable year is less than $500.

Effective Date

This provision would be effective for taxable years beginning after December 31, 1987.

C. Corporate Tax Provisions

1. Modify Computation of Earnings and Profits for Intercorporate Dividends and Basis Adjustments (Overrule Woods Investment Co. Case)

Present Law

In some cases, a corporation can sell stock of a subsidiary for an economic profit without paying tax. This is due to the operation of the consolidated return regulations, which the Tax Court held it must follow in the case of Woods Investment Co. v. Commissioner, 85 T.C. 274 (1985). Those regulations produce this result because they have never been amended to accommodate the impact of certain statutory changes to the definition of earnings and profits that were enacted for other purposes (to assure that individual shareholders could not avoid tax on distributions). In some cases involving accelerated depreciation, a benefit similar to the Woods result might still be obtained outside of consolidation, because a 1984 Code provision did not cover accelerated depreciation.

Explanation of Provision

In determining a parent corporation's basis in the stock of a subsidiary with which it files a consolidated return, the earnings and profits of the subsidiary would be determined without regard to the special adjustments otherwise required under the Code (thus, the excess of earnings and profits adjustments over taxable income would not be taken into account for this purpose). Earnings and profits for this purpose would not include any cancellation of indebtedness income of the subsidiary not taken into account in computing taxable income. Outside a consolidated return context, the provision enacted in 1984 would be expanded to include adjustments for accelerated depreciation.

Effective Date

The provision would apply to stock held on or acquired after the date of committee action (i.e., to dispositions on or after that date). The computation of gain or loss on such dispositions would be computed taking into account the principles of the amendment during the entire holding period of the stock.

2. Limit Consolidated Return Pass-Through

Present Law

Under present law, corporations may file consolidated tax returns if they are members of an affiliated group of corporations. In general, a parent and a subsidiary corporation are members of an affiliated group for this purpose if the parent corporation owns stock of the subsidiary possessing at least 80 percent of the total voting power and value of all the subsidiary stock (excluding certain nonvoting preferred stock).

Under the consolidated return regulations, the consolidated tax return of a parent corporation and an affiliated subsidiary generally allows 100 percent of a subsidiary's losses to offset the parent's income, or, conversely, allows 100 percent of a subsidiary's income to be offset by the parent's losses, even though the parent may own less than 100 percent of the subsidiary's stock.

Explanation of Provision

If the affiliated group owns less than 100 percent of the stock of a subsidiary, the provision would deny consolidation of the percentage of the subsidiary's income or loss attributable to stock owned by nonmembers. All classes of stock would be counted for this purpose.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

3. Repeal Graduated Tax Rates for Personal Service Corporations

Present Law

Under present law, beginning July 1, 1987, corporations are generally subject to a tax at the rate of 34 percent. However, for corporations with a taxable income below $335,000, graduated rates are provided. These rates are 15 percent on taxable income not over $50,000, and 25 percent on taxable income over $50,000 and not over $75,000, with the benefits of these lower rates phased out as taxable income increases from $100,000 to $335,000.

Explanation of Provision

The benefits of the graduated corporate rates would be denied to personal service corporations. A 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 held by the employees performing services for the corporation.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

4. Liquidation of Corporate Subsidiaries

Present Law

Gains on certain distributions to a controlling corporate shareholder (an 80-percent distributee) are not taxed to the distributing corporation in a liquidation. By contrast, a nonliquidating distribution to such a shareholder causes the distributing corporation to recognize gain, though if the two corporations were filing consolidated returns the gain would be deferred until a disposition of the distributed property or certain other events. Certain divisive distributions of corporate stock are also tax-free to the distributing corporation. A sale of stock of a subsidiary to a related corporation is "deemed" to be a dividend, in some instances producing tax results more favorable than an actual sale or an actual dividend.

Explanation of Provision

The provision would generally treat liquidating distributions to an 80-percent corporate distributee that are not taxed under present law in the same manner as nonliquidating distributions.

Gain would specifically be deferred in the case of a liquidating distribution to a parent corporation filing a consolidated return with the distributing corporation, until triggered by a subsequent disposition or certain other events described in the consolidated return regulations. Certain rules for dispositions, including intragroup divisive stock distributions, and essentially equivalent transactions, and the deemed dividend rules for corporations would be modified so that the results are not more favorable than an actual dividend.

Effective Date

The provision would be effective for distributions on or after the date of committee action.

5. Regulated Investment Companies

Present Law

In order to avoid a penalty excise tax, regulated investment companies (RICs), commonly called "mutual funds," must distribute before January 1 of any year at least 97 percent of their ordinary income earned during the prior calendar year and 90 percent of their capital gain net income for the twelve month period ending on October 31 of that year.

Dividends from stock owned by a RIC are includible in the RIC's income when received.

Explanation of Provisions

The distribution required to avoid the penalty excise tax would be increased to 98 percent of ordinary income and 91 percent of capital gain net income.

A RIC would include certain dividends in income on the ex-dividend date for the stock.

Effective Date

The provision increasing the minimum distribution would apply to calendar years beginning after December 31, 1986. The provision including dividends in income on the ex-dividend date would be effective for ex-dividend dates after December 31, 1986.

D. Partnership Provision: Portfolio Income

Present Law

Under present law, deductions from passive trade or business activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Passive income does not include income such as interest and dividends from the holding of stocks and bonds, etc. ("portfolio income"). A limited partnership interest is treated as a passive activity and the income is not treated as portfolio income. Thus, except to the extent that Treasury may prescribe in regulations, income from limited partnerships may be offset by passive losses from other sources.

Explanation of Provision

Losses and deductions of publicly traded limited partnerships would be suspended at the partner level and could be used against income from that partnership with a carryforward mechanism. Limited partners' net income from the partnership would be treated as portfolio (rather than passive) income to the partners under the passive loss rule. Publicly traded limited partnerships would include those whose interests are traded on existing exchanges (including over the counter) and those in which a market is effectively made.

Effective Date

The provision would be effective as if enacted with the passive loss rule (i.e., effective for taxable years beginning after December 31, 1986).

E. Exemption for Eurobond interest paid through the Netherlands Antilles

Present Law

In the summer of 1987, the Treasury Department terminated the tax treaty between the United States and the Netherlands Antilles, except for the provisions limiting the taxation of interest. The provisions that remain in force generally exempt interest paid by U.S. persons to Antilles persons.

Explanation of Provision

In line with a Treasury Department proposal, there would be a statutory exemption for interest on certain outstanding Eurobonds. Interest would be exempt only if it would also be exempt under the Netherlands Antilles treaty.

Effective Date

The provision would be effective for interest paid after date of enactment.

F. Pensions

1. Limit Funding of Overfunded Pension Plans

Present Law

Under present law, subject to certain limitations, an employer may make deductible contributions to a qualified defined benefit pension plan up to the full funding limitation. The full funding limitation is defined as the excess of (1) the accrued liability under the plan for projected benefits over (2) the plan assets. Projected benefits, unlike accrued benefits, are the benefits that are projected to be earned by normal retirement age, rather than the benefit accrued as of the close of the year.

If a defined benefit plan is terminated, the employer's liability to plan participants does not exceed the plan's termination liability (i.e., the liability for benefits determined as of the date of the plan termination). However, contributions to a plan with assets significantly in excess of termination liability may be deductible because the full funding limitation is determined on the basis of projected benefits.

Explanation of Provision

A contribution to a defined benefit pension plan would not be deductible to the extent that (1) it exceeds the present-law full funding limitation, or (2) after the contribution, the plan's assets exceed 150 percent of the plan's termination liability.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

2. PBGC Premiums; Funding

Present Law

Under present law, single-employer defined benefit plans subject to the pension plan termination insurance program are subject to a per-participant PBGC premium of $8.50. Defined benefit plans are subject to minimum funding requirements which generally require that an employer contribute an annual amount sufficient to fund a portion of participants' projected benefits. Present law provides rules pursuant to which employers may voluntarily terminate a defined benefit plan and for liability to the PBGC and plan participants following termination of a plan.

Explanation of Provision

The PBGC premium would be increased. The minimum funding rules would be modified (see separate handout).

Effective Date

This provision generally would be effective for years beginning after December 31, 1987.

G. Estate and Gift Tax Provisions

1. Freeze 55 Percent Tax Rate

Present Law

The estate and gift taxes are unified, so that a single progressive rate schedule is applied to an individual's cumulative gifts and bequests. The generation-skipping transfer tax is computed by reference to the maximum Federal estate tax rate.

For 1987, the gift and estate tax rates begin at 18 percent on the first $10,000 of taxable transfers and reach 55 percent on taxable transfers over $3 million. For transfers occurring after 1987, the maximum gift and estate tax rate is scheduled to decline to 50 percent for taxable transfers over $2.5 million.

Explanation of Provision

The gift and estate tax rates applicable in 1987 would be made permanent.

Effective Date

The provision would be effective for transfers occurring after December 31, 1987.

2. ESOP Estate Tax Deduction

Present Law

The 1986 Act provided generally that the taxable estate of a decedent is determined by deducting from the gross estate 50 percent of the proceeds of a sale of employer securities by an executor to an ESOP or an eligible worker-owned cooperative. The deduction is not available for sales after December 31, 1991.

Under IRS Notice 87-13, the deduction is not available unless (1) the decedent directly owned the securities immediately before death, and (2) the securities are allocable to participants.

Explanation of Provision

S. 591 would be adopted. The bill confirms the positions taken in IRS Notice 87-13. The bill also limits the maximum allowable deduction to 50 percent of the taxable estate (without this deduction) and limits the maximum reduction in tax liability to $750,000. The deduction would be further limited to proceeds of sales of employer securities that are issued by a domestic corporation that has no publicly traded stock outstanding. Sales proceeds attributable to assets transferred from qualified plans other than ESOPs would not be eligible for the deduction. Certain holding period and allocation requirements would apply to the employer securities acquired.

Effective Date

Generally, the confirmation of IRS Notice 87-13 applies to sales of employer securities after October 22, 1986. The other provisions generally apply to sales (or, in certain cases, taxable events) after February 27, 1987.

H. Excise Tax Provisions

1. Telephone Excise Tax: 3-Year Extension at 3 Percent

Present Law

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service. The tax is scheduled to expire after December 31, 1987.

Explanation of Provision

The telephone excise tax would be extended at 3 percent for 3 years, 1988-1990, after which it would expire.

Effective Date

The provision would be effective on January 1, 1988.

2. Collection of Diesel Fuel and Special Motor Fuels Taxes on Sales to Retailers

Present Law

The diesel fuel and special motor fuels excise taxes generally are imposed on the sale of the taxable fuel by a retail dealer to the ultimate consumer of the fuel. Under an exception, retail dealers may elect to have wholesale distributors collect and pay the diesel fuel tax when the fuel is sold to the retailer.

Explanation of Provision

The election to collect the diesel fuel excise tax on sales by wholesale dealers would be made mandatory for all sales. The special motor fuels excise tax likewise would be imposed on sale of the fuel by a wholesale distributor.

Effective Date

The provision would be effective on January 1, 1988.

I. Employment Taxes

1. Repeal Hospital Insurance Wage Base Limit

Present Law

Under present law, a hospital insurance tax is imposed on employers and employees to fund the Medicare trust fund. With respect to any employee, the tax for both the employee and the employer is 1.45 percent of wages up to a limit. In 1987, the limit is $43,800. In 1988, the limit is expected to exceed $45,000.

Explanation of Provision

The limit on the wages subject to the hospital insurance tax would be repealed, so that all wages would be subject to the hospital insurance tax.

Effective Date

This provision would be effective January 1, 1988.

2. Railroad Retirement Tax

Present Law

Under present law, the primary source of income to the Railroad Retirement Account is payroll taxes levied on covered employers and their employees. Currently, both employers and employees pay a tier I tax which is equivalent to the social security tax. In addition, a tier II tax is paid by both rail employers and employees. These taxes are applied to compensation paid to employees, up to a maximum annual amount. Under present law, the tier II rate is 14.75 percent for employers and 4.25 percent for employees. The tier II wage base in 1987 is $32,700.

In addition, present law provides that tier II railroad retirement benefits are includible in income in the same manner as benefits received under a qualified pension plan (Code sec. 72(r)). Under present law, the amounts equivalent to the aggregate increase in tax liabilities attributable to the application of section 72(r) are appropriated to the Railroad Retirement Account. This appropriation from general revenues applies only with respect to benefits received before October 1, 1988.

Explanation of Provision

The provision would increase the railroad retirement Tier II taxes by 2.0 percentage points, effective January 1, 1988. Of the 2.0 percentage point increase, the employer's share is 1.35 percentage points and the employee's share is .65 percentage points.

Additionally, the provision establishes a seven-member Commission on Railroad Retirement Reform to study alternative methods of securing the long-term solvency of railroad retirement. The President would appoint three members, one of whom would represent rail labor, one of whom would represent rail management, and one of whom would represent the general public. The President pro tempore of the Senate would appoint two public members after consultation with the Chairman of the Senate Committee on Labor and Human Resources and the Senate Committee on Finance. The Speaker of the House of Representatives would appoint two public members after consultation with the Chairman of the House Committee on Ways and Means and the House Committee on Energy and Commerce. The Commission would submit its findings to Congress by October 1, 1989.

The provision would extend for two years (to October 1, 1990) the transfer to the Railroad Retirement Account of amounts collected as income tax on tier II benefits.

Effective Date

The provision is effective January 1, 1988.

3. Extend FUTA Repayment Tax

Present Law

Under present law, the gross FUTA tax rate of 6.2 percent of the first $7,000 in wages paid to an employee consists of a permanent component of 6.0 percent and a temporary component of 0.2 percent. The net FUTA tax is 0.8 percent after taking into account the 5.4 percent credit for State unemployment taxes. The funds generated by the temporary portion of the tax have been used to repay advances made from general revenues to the Extended Unemployment Compensation account. These advances were utilized to pay for the now expired Emergency Unemployment Compensation Act and the Federal share of the permanent extended benefit program.

The temporary 0.2 percent tax component is scheduled to expire at the beginning of the first year following the year in which the advances from general revenues are repaid. The advances were fully repaid in 1987. As a result, for the year beginning January 1, 1988, the FUTA tax rate will be 6.0 percent (0.6 percent after taking into account the 5.4 percent credit for State unemployment taxes).

Explanation of Provision

The provision would extend the temporary 0.2 percent FUTA tax for three years, through 1990. Statutory ceilings on the accounts within the Federal Unemployment Trust Fund would be adjusted to accommodate the additional funding.

Effective Date

The provision would be effective January 1, 1988.

J. Certain User Fees

1. Internal Revenue Service

Present Law

The Internal Revenue Service (IRS) currently does not charge taxpayers for issuing letter rulings, determination letters or opinion letters. In 1984, the IRS issued 106,353 advance determination letters on the qualification of corporate and self-employed pension plans, and acted on 69,613 applications and ruling requests from tax-exempt organizations. The IRS also issued 34,246 letter rulings in response to taxpayer's requests during 1984.

Explanation of Provision

The IRS would charge a user fee for letter rulings, determination letters, opinion letters and other similar written statements requested by individuals or organizations.

Effective Date

The provision would apply to requests filed (1) on or after the first day of the second calendar month that begins after the date of enactment of the Act and (2) before October 1, 1990.

2. Bureau of Alcohol, Tobacco, and Firearms

Present Law

The Treasury Department's Bureau of Alcohol, Tobacco, and Firearms (BATF) collects licensing fees and excise taxes on various types of alcohol and tobacco products and on firearms. These fees and taxes are collected pursuant to the Internal Revenue Code, the Federal Alcohol Administration Act, and the Federal Gun Control Act. In addition, occupational taxes are imposed on persons engaged in certain alcohol- and firearms-related businesses and permit requirements apply to these and other persons engaged in alcohol-, tobacco-, and firearms-related businesses.

Explanation of Provisions

The present BATF occupational taxes would be increased as follows:

(1) The alcohol and firearms producer occupational taxes would be increased from $110 per year (brewers) and $500 per year (firearms) to $1,000 per year and extended to distilled spirits plants, wineries, and tobacco manufacturers. A reduced rate of $500 per year would apply to businesses having gross receipts of less than $500,000 in the preceding taxable year.

(2) The present alcohol wholesale and firearms dealer occupational taxes would be increased from $255 per year (liquor and wine), $123 per year (beer), and $200 per year (firearms) to $500 per year.

(3) The present alcohol retail dealer occupational taxes would be increased from $54 per year (liquor and wine) and $24 per year (beer) to $250 per year and would be extended to persons presently required to acquire permits for tax-free use of alcohol. (The special $4.50 tax on limited retail dealers would be repealed.)

(4) The present stamp tax rates for persons receiving drawbacks of certain alcohol taxes would be increased from a range of $25 to $100 per year to $500 per year.

Effective Date

The provisions would be effective on January 1, 1988.

3. Customs Service

Present Law

As enacted in the Omnibus Budget Reconciliation Act of 1986, an _ad valorem_ user fee is applied to all formal entries of merchandise imported for consumption in the amount of 0.22 percent during fiscal year 1987, dropping to the lesser of 0.17 percent or the rate which will provide revenue equal to the appropriated level of Custom's commercial operations in fiscal year 1988 and expiring September 30, 1989. The fee does not apply to articles classifiable in schedule 8 of the Tariff Schedules (including products containing U.S. components which are classifiable in item 807.00 of the Schedules).

Explanation of Provision

The customs user fees provisions would be amended in the following respects:

(1) The schedule 8 exemption would be modified so that the foreign value of item 806.30/807 imports would be subject to the fee (periodic reporting would be allowed for articles which are totally duty-free);

(2) The fees would be extended for one additional year; and

(3) A provision would be added precluding Customs from collecting an annual fee from operators of foreign trade zones and bonded warehouses in addition to the per-entry customs user fee.

Effective Date

This provision would be effective upon date of enactment.

K. IRS Refund Offset Authority: 3-Year Extension

Present Law

Certain Federal agencies are authorized to notify the IRS that a person owes a past due, legally enforceable debt to the agency. The IRS then must reduce the amount of any tax refund due the person by the amount of the debt and pay that amount to the agency. This program expires after December 31, 1987.

Under IRS regulations, the program only affects refunds due individuals, not corporations.

Explanation of Provision

Under the provision, the Federal debt collection program would be extended for three years for all Federal agencies. Also, the program would be expanded to cover corporate, as well as individual, debts owed to Federal agencies.

The IRS and GAO would be required to report on the effectiveness of the program and its effect on voluntary tax compliance.

Effective Date

The provision would be effective on January 1, 1988, and would expire after December 31, 1990.

-- Provide that the two-percent floor on itemized miscellaneous deductions would not apply to indirect deductions taken through publicly offered mutual funds, effective for taxable years beginning after December 31, 1986.

-- Adopt a set of taxpayer protection provisions, including provisions improving the quality of information available to the taxpayer, expanding the ability of taxpayers to recover costs where the IRS pursues a position that is not substantially justified, expanding Tax Court jurisdiction in certain respects, and increasing the types and amounts of property exempt from levy.

-- Allow a parent to elect to claim the unearned income of a dependent on the parent's income tax return, effective for returns for taxable years beginning after December 31, 1987.

-- Provide that expenditures for certain methods of radon contamination mitigation may be eligible for deduction as medical expenses where the taxpayer establishes that radon levels in the home exceed the level recommended by the EPA.

-- Provide that the amendment made to the Tax Reform Act removing recordkeeping requirements as a condition to the excludability of foster care payments applies retroactively to 1978.

-- Provide that a taxpayer would be entitled to a charitable contribution deduction equal to 80 percent of the contribution in excess of ticket purchase costs if, in return for the contribution to a college or university, the taxpayer receives the right to purchase seating in its athletic stadium.

-- The special nonrecognition rule for sale of a principal residence that applies to military service personnel serving overseas would be extended to any foreign service officer posted abroad.

-- Clarify that citrus groves are included in the 7-year class for depreciation purposes.

-- Provide for the extension of the service date deadline for hydroelectric plants where construction of the plant has been delayed by fire, flood, or other natural disaster.

-- Provide that if, during the pendency of a bankruptcy proceeding, an ownership change occurs and section 382 applies, then relief can be provided based on the value of the stock determined immediately after final settlement of the bankruptcy case.

-- Provide relief from the recognition of corporate level gain in the case of transactions involving the transfer of residential cooperative units eligible for the rollover of gain upon sale of a principal residence.

-- Clarify that no holding period requirement exists for purposes of the small closely-held corporation transition relief from the repeal of the General Utilities doctrine.

-- Provide for the application of the prior-law 20-percent phase-down rule relating to the treatment of net operating loss carryforwards in qualified thrift reorganizations; also provide relief from the second change of ownership rule where Federal regulatory agency takes interim control of thrift.

-- Lower the population threshold from 2 million to 1.5 million in the provision defining which cities may have access to Federal tax information.

-- Grants made prior to 1986 by a private foundation to a tax-exempt organization offering technical and business support services for community small businesses would be deemed to be expenditures furthering a charitable purpose, even if the tax-exempt organization accepted equity or royalty consideration from those small businesses unable to pay for such services.

-- Provide that a private operating foundation which met the requirements of 4942(j)(3) as of the end of its last taxable year ending before January 1, 1983, will be treated as described in Section 302(c)(3) of the Tax Reform Act of 1984.

-- Provide that the exception to the harbor maintenance tax found in Code Section 4462(b)(1)(D) would apply to passengers as well cargo.

-- Provide that the harbor maintenance tax will not apply to charitable and relief cargoes shipped abroad by Section 501(c)(3) organizations.

-- Provide certainty with regard to when re-manufacture occurs for purposes of the retail truck excise tax.

-- Provide an increase in the mortgage revenue bond income limits for areas with high housing costs.

-- Provide a method of calculating the mortgage revenue bond purchase price limitation for homes located on land subject to certain ground leases.

-- Treasury Department regulations regarding a special safe-harbor for calculating arbitrage rebate payments would be required to be prospective and could not be made effective through temporary regulations. Report language would be provided clarifying the general intent of the Committee regarding Treasury's regulatory authority on this issue.

-- Rebate on bona fide debt service funds of governmental issues would not be required.

-- The effective date of a technical correction clarifying that advance refundings of pension arbitrage bonds are prohibited would be changed to June 10, 1987, the date of introduction of S. 1350.

-- A change would be made to prevent the benefits of a transitional exception for Georgetown University from being defeated solely as a result of the delay in enactment of the technical corrections bill.

-- Provide more detailed description of waterfront projects described in Section 902(f)(3)(L) of the Tax Reform Act.

-- Qualified plans maintained by public employers would be exempt from the 1986 Act change requiring that distributions commence by April 1 of the calendar year following the calendar year in which the employee attained age 70-1/2.

-- Clarify that section 457 does not apply to benefits provided under a bona fide vacation pay, sick pay, severance pay, compensatory time, disability pay, or death benefit plan.

-- With respect to any employee first hired by a State or local government before January 1, 1989, the limit on benefits under section 415 would equal the benefit such employee accrues under the terms of any defined benefit plan maintained by such State or local government, without regard to any amendment made after the date of Committee action. This rule would only apply to employers that elect to apply, for years beginning after December 31, 1988, the section 415 limits applicable to private, taxable employers, except that the special police and firefighters rule would still apply.

-- Rural telephone cooperatives would be permitted to maintain a section 401(k) plan.

-- The prohibition on IRA investments in collectibles would not apply to State-issued coins in the same manner as the present-law exception for coins issued by the Federal government.

-- The 10% early withdrawal tax applicable to qualified pension plans would not apply to distributions from the Civil Service Retirement System (or the Federal Employees Retirement System (other than the Thrift Plan)) to any Federal employee on or after retirement if the employee retires on or after age 50.

--Repeal $250 billion cap on Treasury authority to issue long term (more than ten year) bonds at interest rates over 4 1/4 percent.

--Financial institutions that deal neither with related parties nor customers of related parties would be treated like banks for purposes of the allocation of interest expenses between U.S. and foreign income.

--U.S. research and development expenses would be apportioned between U.S. and foreign income by allocating 67 percent of such expenses to U.S. income and the remaining 33 percent based on either gross sales or gross income, at the taxpayer's election.

--With respect to foreign sales corporations (FSCs), income from the export of minerals would be able to benefit from both the depletion allowances and the FSC provisions.

--The alternative minimum tax preference for adjusted current earnings would not include annuity contracts under a structured settlement arrangement without regard to whether or not there had been a qualified assignment.

--For alternative minimum tax purposes, book income would be reduced by patronage allocations in the case of rural electric and telephone cooperatives.

--The nonconventional fuels credit would be carried over for use against the regular tax to the extent it cannot be used because the taxpayer is on the alternative minimum tax.

--Installment sales with respect to timeshares and residential lots would be excluded from the alternative minimum tax preference for adjusted current earnings, as they are from the minimum tax base.

--For cooperatives, payments received under a safe harbor lease would be treated as member income, effective as if in the 1981 tax bill (ERTA).

--Charitable gift annuities would not be treated as commercial-type insurance, and the IRS tables used in determining the amount of the charitable contribution would be updated.

--Church self-funded death benefit plans would be treated as life insurance without regard to the requirement that they be life insurance under applicable state law.

--Income earned with respect to pre-need funeral trusts would be taxed on a consolidated trust basis at the trust level.

--Farm credit institutions would be entitled to the same loan loss reserves as banks.

--With respect to loans forgiven under a toxic waste program, whether the taxpayer was a farmer would be determined by looking to the three years preceding acceptance of the loan for purposes of the forgiveness of indebtedness rules (section 108(g)).

--Small banks would be excepted from the requirement to accrue interest on short term loans.

--Government grants to Sematech would not be treated as taxable income.

--Intracompany transfers of good occurring within company premises straddling the U.S. border with a foreign country would be exempted from the Customs users fee.

--The divestiture requirement for grandfathered excess business holdings of private foundations would be modified.

--The windfall profit tax would be repealed.

--Air cargo companies would be considered airlines for purposes of the fringe benefit rules.

--The six year growing period for certain trees would be reduced to four years for purposes of timber capital gains treatment.

-- The simplified cost allocation method for taxpayers acquiring property for resale under the uniform capitalization rules would be clarified (consistant with the conference committee report) to provide that storage costs and related handling costs would be included in inventory based on the ratio of total storage costs for the year to the sum of the taxpayer's beginning inventory balance and gross purchases during the year.

-- Property acquired by state housing agencies through foreclosure and converted to rental use would be eligible for the low income housing credit.

-- Modify the low income housing credit as follows: clarify technical amendment regarding carryforwards of credits; modify waiver authority; modify the definition of "low income"; modify costs included in eligible basis; permit corporate ownership of partnerships qualifying for preferential treatment; and add an exception to the rule requiring transfer of ownership of existing property.

-- Fiscal year taxpayers that could have automatically changed to a calendar year under Treasury regulations (without regard to restrictions on corporations that are partners in partnerships) would be treated as calendar year taxpayers for purposes of the effective date of the installment sale rules.

-- Freelance writers, photographers, and similar taxpayers would be exempted from the uniform capitalization rules.

-- A de minimus exception would be provided for the look back rule with respect to long term contract accounting.

-- Nonrecourse financing provided by a savings and loan institution with respect to a sale by the savings and loan of property acquired by foreclosure would be treated as amounts at risk.

-- For entities required to change their taxable year under section 806 of the tax reform bill, an election would be provided to retain a fiscal year. Partners in electing partnerships and shareholders in electing S corporations would be required to make enhanced estimated tax payments. Deductions for electing personal service corporations would be limited unless certain minimum distributions were made before the end of the calendar year.

Technical Corrections

Adopt S. 1350 with Staff Amendment.