[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS (H.R. 64, H.R. 724, H.R. 1622, H.R. 1667, H.R. 1733, H.R. 2473, H.R. 4575, H.R. 4578, H.R. 4596, H.R. 4597, and H.R. 4603)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON MAY 12, 1986

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The bills described in this pamphlet [1] have been scheduled for a public hearing on May 12, 1986, by the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means.

The 11 bills scheduled for the hearing are: (1) H.R. 64 (targeted jobs credit for employment of displaced homemakers); (2) H.R. 724 (release of certain seized property to the owner); (3) H.R. 1622 (exclusion for value of certain employee lodging furnished by educational institutions); (4) H.R. 1667 (deduction for loss in value of certain freight forwarder authorities); (5) H.R. 1733 (deduction for loss in value of certain bus operating authorities); (6) H.R. 2473 (deduction disallowance for damages for fraud violations); (7) H.R. 4575 (prevent the avoidance of certain pension requirements through the use of leased employees); (8) H.R. 4578 (cover over of excise taxes on Virgin Islands rum); (9) H.R. 4596 (Tax Court provisions); (10) H.R. 4597 (BATF administrative provisions); and (11) H.R. 4603 (hazardous substance removal costs treated as qualifying distribution for a private foundation).

The first part of the pamphlet is a summary of the bills. The second part provides a more detailed description of the bills, including present law, explanation of provisions, and effective dates.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of Tax Bills (H.R. 64, H.R. 724, H.R. 1622, H.R. 1667, H.R. 1733, H.R. 2473, H.R. 4575, H.R. 4578, H.R. 4596, H.R. 4597, and H.R. 4603)* (JCS-10-86), May 9, 1986.

I. SUMMARY

1. H.R. 64—Mr. Bilirakis

Targeted Jobs Credit for Employment of Displaced Homemakers

Employers are allowed a targeted jobs tax credit for hiring individuals who are recipients of payments under mean-tested transfer programs, economically disadvantaged (as measured by family income), or disabled (Code sec. 51). The credit generally equals 50 percent of the first $6,000 of qualified first-year wages and 25 percent of the first $6,000 of qualified second-year wages. Under present law, the credit does not apply to individuals who first begin work for the employer after 1985.

The bill would make employment of displaced homemakers eligible for the targeted jobs credit, effective after the date of enactment, and would provide that the termination date for the credit under present law would not apply with respect to hiring of displaced homemakers.

2. H.R. 724—Mr. Stark

Release of Certain Seized Property to the Owner

The Federal Government has the power under present law to seize and sell the property of a delinquent taxpayer, after giving proper notice and demand for payment (sec. 6331). Before selling the seized property, the Government must set a minimum price for it. If no bid on the property meets or exceeds the minimum price, the Government is deemed to purchase the property at this minimum price.

The bill would require the IRS to determine, prior to the sale, whether purchase of the property at the minimum price would be in the best interests of the Government. Property not sold to the highest bidder would be deemed to be purchased by the Government only if the purchase were in its best interests. Otherwise, the property would be released to the owner, subject to a government lien. Also, the expense of the levy and sale would be added to the amount of delinquent taxes due. The bill would be effective retroactively for sales of seized property conducted after 1984.

3. H.R. 1622—Mrs. Kennelly and Messrs. Frenzel, Conte, Frank, and Gejdenson

Exclusion for Value of Certain Employee Lodging Furnished by Educational Institutions

Present law (sec. 119) excludes from an employee's gross income the value of lodging provided by the employer if (1) the lodging is furnished for the convenience of the employer, (2) the lodging is on the business premises of the employer, and (3) the employee is required to accept the lodging as a condition of employment. (A similar exclusion applies for employment tax purposes.) Several court decisions have held that on-campus housing furnished to faculty by an educational institution did not satisfy the section 119 requirements, and hence that the fair rental value of the housing (less any amounts paid for the housing by the employee) was includible in the employee's gross income and constituted wages for income tax withholding and employment tax purposes.

The bill would provide a permanent statutory exclusion, for income and employment tax purposes, for the value of lodging furnished by, or on behalf of, schools, colleges, and universities to employees (or the employee's spouse or dependents), except to the extent that the direct operating cost of the lodging to the educational institution exceeds the rent paid by the employee. The exclusion would apply if the lodging is located on, or in the proximity of, a campus of the educational institution. The bill would apply retroactively to taxable years beginning after 1972.

4. H.R. 1667—Mrs. Kennelly

Deduction for Loss in Value of Certain Freight Forwarder Authorities

and

5. H.R. 1733—Messrs. Jenkins, Schulze, and Flippo

Deduction for Loss in Value of Certain Bus Operating Authorities

Under present law, courts have denied ordinary loss deductions (sec. 165) for any decrease in value of an operating permit or license attributable to enactment of legislation that expands the number of issued licenses or permits. In 1981, after the deregulation of the trucking industry, the Congress allowed trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the Economic Recovery Tax Act of 1981).

The value of freight forwarder operating authorities has diminished as a result of administrative deregulation. The value of bus operating authorities has diminished as a result of Federal legislation deregulating the intercity bus industry. H.R. 1667 and H.R. 1733 would provide tax deductions for the owners of certain freight forwarder and bus operating authorities, respectively, similar to deductions granted in 1981 with respect to motor carrier authorities.

The bill relating to freight forwarder operating authorities (H.R. 1667) would apply retroactively to taxable years ending after June 30, 1980. The bill relating to bus operating authorities (H.R. 1733) would apply retroactively to taxable years ending after November 18, 1982.

6. H.R. 2473—Mr. Stark

Deduction Disallowance for Damages for Fraud Violations

Under present law, ordinary and necessary expenses of carrying on a trade or business generally are deductible (sec. 162). No deduction is allowed, however, for illegal payments, bribes, and kickbacks, or for specifically enumerated types of payments with respect to which the Congress concluded that allowing a deduction would frustrate a public policy objective. These provisions do not disallow deductions for the payment of damages in connection with an action involving fraud in the conduct of a trade or business.

Under the bill, no deduction would be allowed for any payment of restitution or other damages in connection with the conviction of (or the entering of a guilty or nolo contendere plea to) a violation of law involving fraud. The bill would apply retroactively to amounts paid after May 15, 1985.

7. H.R. 4575—Mr. Rostenkowski

Prevent the Avoidance of Certain Pension Requirements Through the Use of Leased Employees

For purposes of certain requirements applicable to qualified pension plans (including the rules relating to coverage), individuals who perform services for a business other than as employees as ordinarily defined may be treated in certain situations as "leased" employees of that business. The bill would modify the definition of a leased employee by (1) eliminating, as a condition of leased employee status, the requirement that an individual perform services for the recipient pursuant to an agreement between the recipient and a leasing organization, and (2) by expanding the circumstances under which services are treated as performed by leased employees. The bill would also eliminate the safe-harbor exemption from the leased employee provisions for individuals covered under certain money purchase pension plans.

In addition, the bill would authorize the Treasury Department to issue regulations reducing the recordkeeping obligations of employers using the services of persons other than employees for a small percentage of the employer's total workload and on a short-term basis. The bill generally would apply for plan years beginning after 1986.

8. H.R. 4578—Messrs. de Lugo, Udall, Young of Alaska, and Lagomarsino

Cover Over of Excise Tax Revenues From Virgin Islands Rum

Excise tax revenues on certain articles coming into the United States from Puerto Rico or the Virgin Islands are "covered over" (i.e., paid) to the Treasury of the relevant possession (sec. 7652). In the case of distilled spirits, this cover over is limited to $10.50 per proof gallon.

The bill would allow the full amount of the distilled spirits excise tax (i.e., $12.50 per proof gallon) to be covered over with respect to

Virgin Islands rum. The bill would apply retroactively to distilled spirits brought into the United States after September 30, 1985.

9. H.R. 4596—Mr. Rangel

Tax Court Provisions

The bill would provide the U.S. Tax Court with the assistance of United States Marshals, specify the salary level and travel expenses allowable to Special Trial Judges, permit appeals from interlocutory orders of the Tax Court, permit retired Tax Court judges to elect to practice law and receive reduced retirement pay, and clarify the jurisdiction of the Tax Court over the penalty for failure to pay tax.

10. H.R. 4597—Mr. Rangel (by Request)

BATF Administrative Provisions

Manufacture, importation, and ownership of machine guns, destructive devices, and certain other types of firearms are restricted under the Internal Revenue Code. Where permitted to be manufactured, imported, or owned by persons other than the Federal Government, these firearms must be registered with the Bureau of Alcohol, Tobacco, and Firearms (BATF). Unregistered firearms are subject to seizure by and forfeiture to the Federal Government. The bill would waive certain general Code requirements for administrative and judicial review of seizures of property in the case of unregistered firearms.

Under present law, firearms registration, as well as all tax returns for alcohol, tobacco, and firearms excise taxes, must be filed with Internal Revenue Service offices. The bill would authorize BATF to require filings directly with that agency rather than with the IRS for all registrations and returns of taxes administered by BATF.

11. H.R. 4603—Mr. Hubbard

Hazardous Substance Removal Costs Treated as Qualifying Distributions for a Private Foundation

To avoid "penalty" excise taxes under Code section 4942, a private grantmaking foundation must make expenditures or distributions for charitable purposes equal to a specified "distributable amount." The bill would reduce the otherwise applicable distributable amount for the James Graham Brown Foundation, Inc., by the amount of expenditures paid, incurred, or set aside by that Foundation for investigatory costs and direct costs of removal or taking remedial action with respect to hazardous substances at the site of a business bequeathed to and formerly operated by the Foundation. The bill would apply retroactively to taxable years beginning after 1982.

II. DESCRIPTION OF THE BILLS

1. H.R. 64—Mr. Bilirakis

Targeted Jobs Credit for Employment of Displaced Homemakers

Background and Present Law

The targeted jobs tax credit (Code sec. 51) is intended to provide a tax incentive to business for hiring specific, targeted categories of individuals. It was enacted in the Revenue Act of 1978 as a substitute for the "new jobs" credit for increased employment that was available in 1977 and 1978. As originally enacted, the targeted jobs credit was scheduled to terminate after 1981.

The availability of the targeted jobs credit was extended by the Economic Recovery Act of 1981 for one year, by the Tax Equity and Fiscal Responsibility Act of 1982 for two years, and by the Deficit Reduction Act of 1984 for one year. Each statute also modified the targeted group definitions and made several administrative and technical changes in the credit provisions. Under present law, the credit does not apply to wages paid to individuals who begin work for the taxpayer after December 31, 1985.[2]

For individuals who were hired and began work before 1986, the credit is available if the individual is a member of one or more of nine targeted groups. The targeted groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths age 18 through 24; (3) economically disadvantaged Vietnam-era veterans; (4) SSI recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students age 16 through 19; (7) economically disadvantaged former convicts; (8) AFDC recipients and WIN registrants; and (9) economically disadvantaged summer youth employees age 16 or 17.

For pre-1986 hirees, the credit generally equals 50 percent of the first $6,000 of qualified first-year wages and 25 percent of the first $6,000 of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment, or a maximum credit of $4,500 over a two-year period.[3] (With respect to economically disadvantaged summer youth employees, however, the credit is equal to 85 percent of up to $3,000 of wages, for a maximum credit of $2,550.) The employer's deduction for wages must be reduced by the amount of the credit.

[2] H.R. 3838 (the Tax Reform Act of 1985), as passed by the House in December 1985, would extend the credit for two more years, with several modifications.

[3] H.R. 3838 as passed by the House would eliminate the second-year tax credit and reduce the first-year credit to 40 percent of the first $6,000 of qualified wages, except with respect to economically disadvantaged summer youth employees.

Explanation of the Bill

The bill would treat displaced homemakers as an additional targeted group eligible for the targeted jobs tax credit.

Under the bill, the term displaced homemaker means an individual who meets both of the following criteria. First, the individual has not worked in the labor force for a substantial number of years but has worked, during those years, in the home providing unpaid services to family members. Second, either the individual has been dependent on public assistance or another family member but is no longer supported by that income, or the individual is receiving public assistance on account of dependent children in the home.

The bill provides that the present-law rule terminating the credit for individuals who begin work for the employer after December 31, 1985, would not apply to displaced homemakers.

Effective Date

The bill would apply to amounts paid or incurred after the date of enactment to individuals who begin work for the employer after that date.

2. H.R. 724—Mr. Stark

Release of Certain Seized Property to the Owner

Present Law

The Federal Government has the power, after proper notice and demand, to seize and sell the property of a delinquent taxpayer (sec. 6331). As soon as practicable after seizure, the Government is required to give written notice of the seizure to the owner of the property (sec. 6335). This notice must describe the property seized and specify the sum of money owed and demanded for release of the property. The Government also must give notice of the sale of such seized property to its owner as soon as practicable after seizure. This notice must specify the property to be sold as well as the time, place, manner, and conditions of the sale.

Before the sale, the Government is required to set a minimum price for the property, taking into account the expenses to the Government of the levy and sale. At the sale, the property is sold to the highest bidder who meets or exceeds the minimum price. If no bid meets or exceeds the minimum price, the property is deemed to be sold to the Government for the minimum price. Thus, the Government has no discretion under present law in purchasing the property itself when no bid meets or exceeds the minimum price.

Explanation of the Bill

This bill would require that, before the sale of the property, the IRS is to determine (based upon criteria prescribed by the Treasury) whether the purchase of the property at the minimum price would be in the best interests of the Federal Government. Property would continue to be sold to the highest bidder who meets or exceeds the minimum price.

If no bid meets or exceeds the minimum price, the Government would purchase the property at the minimum price only if the purchase were in its best interests. If the purchase were determined not to be in the best interests of the Government, the property would be released back to the owner. The property would still be subject to a Government lien. Also, any expenses of the levy and sale would be added to the amount of delinquent taxes due.

Effective Date

The bill would be effective retroactively for sales of seized property conducted after December 31, 1984.

3. H.R. 1622—Mrs. Kennelly and Messrs. Frenzel, Conte, Frank, and Gejdenson

Exclusion for Value of Certain Employee Lodging Furnished by Educational Institutions

Present Law

Code section 119 excludes from an employee's gross income the value of lodging provided by the employer if (1) the lodging is furnished for the convenience of the employer, (2) the lodging is on the business premises of the employer, and (3) the employee is required to accept the lodging as a condition of employment. Similar exclusions apply for FICA and FUTA tax purposes (secs. 3121(b)(19), 3306(b)(14)).

Several court decisions have held that on-campus housing furnished to faculty or other employees by an educational institution did not satisfy the section 119 requirements.[4] Therefore, the fair rental value of the housing (less any amounts paid for the housing by the employee) was includible in the employee's gross income and constituted wages for income tax withholding and employment tax purposes.

1984 Legislation

The Deficit Reduction Act of 1984 (P.L. 98-369) prohibited the Treasury Department from issuing, prior to January 1, 1986, any income tax regulations that would provide for inclusion in gross income of the excess of the fair market value of qualified campus lodging over the greater of (1) the operating costs paid in furnishing the lodging, or (2) the rent received. This moratorium on regulations applied only with respect to qualified campus lodging furnished after December 31, 1983, and before January 1, 1986.

Qualified campus lodging is defined as lodging furnished by a school, college, or university to any of its employees, including non-

[4] *Bob Jones Univ.* v. *U.S.*, 670 F.2d 167 (Ct. Cl. 1982); *Goldsboro Christian Schools, Inc.* v. *U.S.*, 79-1 CCH USTC para. 9266, E.D.N.C. 1978 (value of lodging furnished to faculty constitutes wages subject to income tax, FICA, and FUTA withholding, in light of "long and consistent history of regulations and rulings, expressly and explicitly applying withholding taxes to lodging not furnished for the employer's convenience * * *"), aff'g order entered in *Goldsboro Christian Schools, Inc.* v. *U.S.*, 436 F.Supp. 1314 (E.D.N.C. 1977), aff'd per curiam in unpublished opinion (4th Cir. 1981), aff'd 103 S. Ct. 2017 (1983); *Winchell* v. *U.S.*, 564 F.Supp. 131 (D. Neb. 1983) (value of campus home taxed to college president); and *Coulbourn H. Tyler*, 44 CCH Tax Ct. Mem. 1221 (1982).

faculty employees, or to the employee's spouse or dependents. The moratorium applied only with respect to employer-furnished lodging that is located on a campus of, or in close proximity to a campus of, the educational institution. Under the Act, the moratorium did not apply with respect to any amount of the value of lodging if such amount was treated as wages or included in income when furnished.

The purpose of providing for the moratorium was to allow further time for consideration of arguments by schools and universities that special tax rules governing treatment of housing furnished to their employees should be provided by statute.

Explanation of the Bill

The bill would provide a permanent statutory exclusion for the fair market value of campus lodging furnished by a school, college, or university, except to the extent that the direct operating cost of the lodging to the educational institution exceeds the rent paid by the employee. Thus, if the rent at least equals the institution's direct operating costs for the housing, no amount would be included in the employee's income or wages for income or employment tax purposes.

The exclusion would apply to lodging that is (1) located on, or in the proximity of, a campus of the institution, and (2) furnished to the employee (or the employee's spouse or dependents) by or on behalf of the institution.

Effective Date

The bill would apply retroactively to taxable years beginning after 1972.

4. H.R. 1667—Mrs. Kennelly

Deduction for Loss in Value of Certain Freight Forwarder Authorities

and

5. H.R. 1733—Messrs. Jenkins, Schulze, and Flippo

Deduction for Loss in Value of Certain Bus Operating Authorities

Background

Freight forwarder operating authorities

Beginning in 1980, the Interstate Commerce Commission ("ICC") has granted licenses to freight forwarders without regard to the prior scheme of economic regulation. Thus, freight forwarders have not been subjected to any significant regulatory entry restriction. The ICC's liberal administrative licensing policies and practices reflect a deregulatory philosophy that was explicitly declared in legislation that deregulated other segments of the national transportation industry (such as the Motor Carrier Act of 1980, discussed below). As a result of the ICC's administrative deregulation, the value of freight forwarder operating authorities has diminished.

Bus operating authorities

Prior to enactment of the Bus Regulatory Reform Act of 1982, intercity bus operators were required to obtain a bus operating authority before providing service on a particular route. Only a limited number of bus operating authorities were issued. Persons wishing to enter a route often purchased an existing business that already owned an operating authority, and substantial amounts were paid for these operating authorities. Thus, the value of bus operating rights constituted a substantial part of a bus operator's assets and a source of loan collateral.

The 1982 statute, in deregulating intercity buses, allows intercity bus operators to enter on, expand, drop, or change routes, free of Federal barriers. As a result of the relative ease of entry into the intercity bus business, the value of bus operating authorities had diminished.

Tax treatment of motor carrier operating authorities

The owners of freight forwarder and bus operating authorities state that their situation is similar to that faced by owners of motor carrier operating authorities after enactment of the Motor Carrier Act of 1980. That statute deregulated the trucking industry; as a result, motor carrier operating authorities lost significant value. In the Economic Recovery Tax Act of 1981, the Congress enacted a provision allowing trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 166 of the 1981 Act).

Present Law

A deduction is allowed for any loss incurred in a trade or busines during the taxable year, if the loss is not compensated for by insurance or otherwise (Code sec. 165(a)). In general, the amount of the deduction equals the adjusted basis of the property giving rise to the loss (sec. 165(b)). Treasury regulations provide that, to be deductible, a loss must be evidenced by a closed and completed transaction (i.e., must be "realized"), and must be fixed by an identifiable event (Treas. Reg. sec. 1.165–1(b)).

As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition. Thus, for a loss to be allowed as a deduction, generally the business must be discontinued or the property must be abandoned (Treas. Reg. sec. 1.165–2)). Further, if the property is a capital asset and is sold or exchanged at a loss, the deduction of the resulting capital loss is subject to limitations (secs, 1212, 1211, and 165(f)).

The courts have denied a loss deduction where the value of an operating permit or license decreased as the result of legislation expanding the number of licenses or permits that could be issued. In the view of several courts,[5] the diminution in the value of a license

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[5] *See, e.g., Consolidated Freight Lines, Inc.* v. *Comm'r,* 37 B.T.A. 576 (1938) *aff'd,* 101 F.2d 813 (9th Cir.) *cert. denied,* 308 U.S. 562 (1939) (denial of loss deduction attributable to loss of monopoly due to State deregulation of the interstate motor carrier industry); *Monroe-W. Beatty,* 46 T.C. 835 (1966) (no deduction allowed for diminution in value of liquor license resulting from change in State law limiting grant of such licenses).

or permit does not constitute an event giving rise to a deductible loss if the license or permit continues to have value as a right to carry on a business.

Explanation of H.R. 1667

H.R. 1667 would allow an ordinary deduction ratably over a 60-month period for taxpayers who held freight forwarder authorities on July 1, 1980 (the date of enactment of the Motor Carrier Act of 1980). The amount of the deduction would be the aggregate adjusted basis of all freight forwarder operating authorities held by the taxpayer on July 1, 1980, or acquired after that date under a binding contract in effect on July 1, 1980.

The 60-month period would begin on July 1, 1980, or, at the taxpayer's election, with the first month of the first taxable year beginning after July 1, 1980.

Under regulations to be prescribed by the Treasury Department, a taxpayer holding an operating authority on July 1, 1980, would be able to elect to allocate to the operating authority a portion of the cost basis to the acquiring corporation of stock in an acquired corporation. The election would be available only if the operating authority was held directly by the acquired corporation or was held indirectly through one or more other corporations. In either case, a portion of the stock basis could be allocated to the operating authority only if the acquiring corporation would have been able, if it has received the operating authority in one or more corporate liquidations immediately following the stock acquisition, to allocate such portion to the operating authority under prior-law section 334(b)(2). The election would apply only if the stock was acquired on or before July 1, 1980 (or pursuant to a binding contract in effect on such date).

Effective date.—The bill would be effective retroactively for taxable years ending after June 30, 1980.

Explanation of H.R. 1733

H.R. 1733 would allow an ordinary deduction ratably over a 60-month period for taxpayers who held one or more bus operating authorities on November 19, 1982 (the date of enactment of the Bus Regulatory Reform Act of 1982). The amount of the deduction would be the aggregate adjusted bases of all bus operating authorities that were held by the taxpayer on November 19, 1982, or acquired after that date under a contract that was binding on that date.

The 60-month period would begin with the later of November 1, 1982, or, at the taxpayer's election, the first month of the taxpayer's first taxable year beginning after that date.

Under regulations to be prescribed by the Treasury, a taxpayer (whether corporate or noncorporate) holding an eligible bus operating authority would be able to elect to allocate to the authority a portion of the cost to the taxpayer of stock in an acquired corporation that held (directly or indirectly) any bus operating authority at the time its stock was acquired. In such a case, a portion of the stock basis could be allocated to the authority only if the corporate or noncorporate taxpayer would have been able to make such an allocation had the authority been distributed in a liquidation to which prior-law section 334(b)(2) applied. The election would be available only if the stock was acquired on or before November 19, 1982 (or pursuant to a binding contract in effect on such date).

Effective date.—H.R. 1733 would be effective retroactively for taxable years ending after November 18, 1982.

6. H.R. 2473—Mr. Stark

Deduction Disallowance for Damages for Fraud Violations

Present Law

Under present law, ordinary and necessary expenses of carrying on a trade or business generally are deductible (sec. 162(a)). However, the Code expressly provides that certain business expenses that otherwise might be treated as ordinary and necessary are nondeductible.

These nondeductible expenses include bribes, kickbacks, and other payments that are illegal under Federal or State law. Also, specified types of payments that are not illegal, but are of such nature that the Congress has determined that deductibility would frustrate a public policy objective, are made nondeductible. In enumerating the specific deductions that are disallowed, the Congress intended that no other deductions would be disallowed on the basis of frustration of public policy.[6]

Illegal payments for which deductions are denied include illegal payments, bribes, or kickbacks to government officials (sec. 162(c)(1)). In addition, no deductions are allowed for payments that are illegal under a generally enforced law of any State, where the payor is subject to criminal penalty or loss of license or privilege to carry on a trade or business (sec. 162(c)(2)).

Payments that may not themselves be illegal, but for which deductions are disallowed on public policy grounds, include the payment of a fine or similar penalty to a government for the violation of any law (sec. 162(f)), as well as two-thirds of certain payments in connection with antiturst prosecutions that carry treble damage penalties (sec. 162(g)). In addition, no deductions are allowable in connection with the trade or business of trafficking in controlled substances (sec. 280E). Further, no deduction is allowed for any kickback, rebate, or bribe made by any person who furnishes items or services that will be paid or reimbursed in whole or in part under the Social Security Act, or with Federal funds under a State plan approved under the Social Security Act (Medicare, Medicaid, etc.), if the kickback, rebate, or bribe was made in connection with the provision of such items or services (sec. 162(c)(3)).

Payments of compensatory and punitive damages by a defendant in an action for fraud in connection with business activities have been held to be deductible under present law because no provision of the Code specifically denies a deduction for such expenses.[7]

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[6] *See* S. Rept. 91-552, 91st Cong., 1st Sess., p. 274.

[7] Rev. Rul. 80-211, 1980-2 C.B. 57; *Ostrom* v. *Comm'r*, 77 T.C. 608 (1981).

Explanation of the Bill

Under the bill, no deduction would be allowed for any payment of restitution or other damages in connection with the conviction of (or the entering of a guilty or nolo contendere plea to) a violation of law involving fraud.

Effective Date

The bill would be effective retroactively for amounts paid after May 15, 1985.

7. H.R. 4575—Mr. Rostenkowski

Prevent the Avoidance of Certain Pension Requirements Through the Use of Leased Employees

Present Law

In general

Under a plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan), an employer is allowed a deduction, within certain limitations, for contributions to a trust to provide employee benefits. Similar rules apply to plans funded with annuity contracts. A qualified plan may be a pension, profit-sharing, or stock bonus plan.

The qualification standards of present law include a requirement that a qualified plan must cover employees in general, rather than merely officers, shareholders, or highly compensated employees. A plan generally satisfies the present-law coverage rule if (1) it benefits a significant percentage of the employer's workforce (percentage test), or (2) it benefits a classification of employees determined by the IRS not to discriminate in favor of employees who are officers, shareholders, or highly compensated (classification test). For purposes of determining whether a plan satisfies the coverage requirement, all employees (other than certain excludable employees) are taken into account.

Leased employees

For purposes of certain requirements (including the coverage requirements) for qualified plans, simplified employee pensions (SEPs), and certain tax-favored fringe benefit plans, an individual who performs services for another person (the recipient), but who is not the recipient's common-law employee, is treated as the recipient's employee (a leased employee) if the following three conditions are satisfied:

(1) the services are performed by the individual pursuant to an agreement between the recipient and a third person (the leasing organization) who is otherwise treated as the individual's employer;

(2) the individual has performed services for the recipient (or for the recipient and persons related to the recipient) on a substantially full-time basis for a period of at least 12 months; and

(3) the services are of a type historically performed by employees in the recipient's business field. For this purpose, the rules relating

to services historically performed by employees in the case of an affiliated service organization (sec. 414(m)) are to apply.

For purposes of determining whether a qualified plan, a SEP, or a fringe benefit plan maintained by the recipient satisfies the qualification requirements, the leased employee is treated as the recipient's employee for periods after the close of the 12-month period described above. However, the leased employee's years of service (sec. 411(a)) for the recipient are determined by taking into account the entire period for which the leased employee performed services for the recipient (or for a related person).

Although leased employees are generally treated as employees of the recipient, present law also requires that a leased employee be treated as an employee of the leasing organization (i.e., for purposes of testing the qualified status of any plan maintained by the leasing organization).

Contributions or benefits for the leased employee which are provided by the leasing organization under a qualified plan or a SEP maintained by the leasing organization are treated as if provided by the recipient to the extent that those contributions or benefits are attributable to services performed by the leased employee for the recipient.

Safe-harbor rule

Under a safe-harbor rule, an individual who otherwise would be treated as a recipient's employee is not so treated if certain requirements are met with respect to contributions and benefits provided for the individual under a qualified money purchase pension plan maintained by the leasing organization. The safe-harbor rule applies if the money purchase pension plan provides that (1) the individual is a plan participant on the first day on which the individual becomes an employee of the leasing organization; (2) the employee's rights to, or derived from, employer contributions under the plan are at all times nonforfeitable (sec. 411(a)); and (3) amounts are to be contributed by the employer on behalf of the employee at a rate not less than 7½ percent of the employee's compensation for the year (the 7½-percent contribution may not be reduced by integration with social security).

The safe harbor applies only for purposes of the employee leasing provisions of the Code (sec. 414(n)). If an individual is an employee of the recipient under the common-law definition of the term, or if an individual is otherwise deemed an employee of the recipient (e.g., by reason of sec. 414(m)), then the individual continues to be treated as an employee of the recipient for purposes of the enumerated employee benefit provisions.

Explanation of the Bill

Overview

The bill would modify the definition of a leased employee by (1) eliminating, as a condition of leased employee status, the requirement that an individual perform services for the recipient pursuant to an agreement between the recipient and a leasing organization, and (2) by expanding the circumstances under which services will be treated as those performed by leased employees. The bill also would eliminate the 7½-percent safe-harbor exemption from the leased employee provisions for individuals covered under certain money purchase pension plans. In addition, the bill would authorize the Treasury Department to issue regulations reducing the recordkeeping requirements of employers using the services of persons other than employees for a small percentage of the employer's total workload on a short-term basis.

Conditions of leased employee status

The bill would provide that an individual who is not a common law employee of a recipient, but who has performed services for the recipient (including persons related to the recipient) on a substantially full-time basis for a period of at least one year, is treated as a leased employee of the recipient if either (1) such services are of a type historically performed, in the business field of the recipient, by employees, or (2) such services are of a type performed for the recipient on a long-term basis during each of the three preceding plan years.

Thus, the bill would eliminate, as a condition of leased employee status, the requirement that an individual's services be performed pursuant to an agreement between the recipient and a leasing organization. In addition, under the bill, if an individual's services are not of a type historically performed in the business field of the employer, the individual nevertheless would be treated as a leased employee if the individual's services are of a type performed for the recipient on a long-term basis during each of the three preceding plan years, and the individual otherwise satisfies the conditions of leased employee status.

Under the bill, services would be treated as performed on a long-term basis during any plan year if at least one individual performed services of such type for the recipient (or related persons or predecessors of the recipient) for at least 1,000 hours during the plan year.

Safe-harbor exemption

The bill would eliminate the safe-harbor rule under which a leased employee is not treated as the employee of the recipient organization if the individual is a participant in a money purchase pension plan that is maintained by the leasing organization and that meets the requirements described above.

Minimizing recordkeeping requirements

The bill would authorize the Treasury to issue regulations minimizing the recordkeeping requirements of employers using the services of persons other than employees for a small percentage of the employer's total workload and on a short-term basis.

Effective Date

The provisions of the bill generally would be effective for plan years beginning after December 31, 1986. However, the provision authorizing the Treasury Department to issue regulations minimizing the recordkeeping requirements of certain employers would apply retroactively to taxable years beginning after December 31, 1983.

8. H.R. 4578—Messrs. de Lugo, Udall, Young of Alaska, and Lagomarsino

Cover Over of Excise Tax Revenues From Virgin Islands Rum

Present Law

An excise tax is imposed on articles coming into the United States from Puerto Rico and the Virgin Islands in the same manner and amount as such tax that would be imposed if the articles were manufactured or produced in the United States (Code sec. 7652). This tax is in lieu of the excise tax that would be imposed if the articles were manufactured in or imported into the United States.

An excise tax of $12.50 per proof gallon is imposed on distilled spirits produced in or imported into the United States. The tax rate was increased from $10.50 per proof gallon on October 1, 1985, by the Deficit Reduction Act of 1984 (P.L. 98-369).

Prior to the 1984 Act, the full amount of revenues collected from the tax on articles coming into the United States from Puerto Rico or the Virgin Islands was covered over (paid) to the Treasury of the possession from which the articles came. The 1984 Act limited the cover over with respect to distilled spirits to a maximum of $10.50 per proof gallon (i.e., the prior-law tax rate) and to rum. The legislative history indicates that the Congress believed that cover over payments should not be expanded, absent an examination of the overall question of whether such payments are appropriate.[8]

Explanation of the Bill

The bill would allow a cover over of the full amount of excise tax paid (i.e., $12.50 per proof gallon) with respect to rum produced in the Virgin Islands. Cover over of the tax on Puerto Rican spirits, or Virgin Islands spirits other than rum, would remain subject to a $10.50 per proof gallon limitation.

Effective Date

The bill would apply to articles containing distilled spirits brought into the United States after September 30, 1985 (i.e., the effective date of the distilled spirits tax increase and the current limit on the amount of the cover over).

[8] *See*, S. Prt. 98-169, Vol. I (April 2, 1984), 98th Cong., 2d Sess. p. 1000.

9. H.R. 4596—Mr. Rangel

Tax Court Provisions

a. U.S. Marshals

Present Law

United States Marshals provide courtroom security, among other duties. It is not clear that the Tax Court has the authority to request the assistance of U.S. Marshals, because the Tax Court is an Article I (rather than Article III) court.

Explanation of the Bill

The bill would require that the U.S. Marshal for any district in which the Tax Court is sitting must attend any session of the Tax Court, when requested to do so by the Chief Judge of the Tax Court.

Effective Date

This provision would be effective on the date of enactment of the bill.

b. Special Trial Judges

Present Law

The Chief Judge of the Tax Court is authorized to appoint Special Trial Judges, who assist in the work of the Court. The Code provides that their salary is determined by the procedures relating to the Commission on Executive, Legislative, and Judicial Salaries. The Executive Order implementing that provision fails to include Special Trial Judges.

Prior to January 17, 1985, Special Trial Judges were entitled to reimbursement for travel expenses on the same basis as other Federal judges. On that date, the Comptroller General determined that they were entitled only to reduced reimbursement pursuant to the Federal Travel Regulations.

Explanation of the Bill

The bill would consolidate in one new section of the Code a number of the provisions relating to the Special Trial Judges. The bill would also specify that Special Trial Judges are to be paid 90 percent of the salary paid to Tax Court Judges, and that Special Trial Judges may be reimbursed for travel and subsistence expenses to the same extent as are Tax Court Judges.

Effective Date

Generally, these provisions would be effective on the date of enactment of the bill. The provision relating to the salary of Special Trial Judges would be effective on the first day of the first month beginning after the date of enactment.

c. Appeals from interlocutory orders

Present Law

The Second Circuit has held that the United States Courts of Appeals do not have jurisdiction over any interlocutory order issued by the Tax Court (*Shapiro* v. *Comm'r.* 632 F.2d 170 (2d Cir., 1980)).

Explanation of the Bill

The bill would authorize an appeal from an interlocutory order of the Tax Court if a judge of the Tax Court includes in an interlocutory order a statement that a controlling question of law is involved, that there is substantial ground for difference of opinion regarding the question of law, and that an immediate appeal from the order might materially advance the ultimate termination of the litigation.

The Court of Appeals would be given discretion as to whether or not to permit the appeal. Neither the application for nor the granting of an appeal would stay proceedings in the Tax Court unless a stay is ordered by either the Tax Court or the Court of Appeals.

Effective Date

This provision would apply to any action or proceeding in the Tax Court commenced after the date of enactment.

d. Election to practice law after retirement and receive reduced retirement pay

Present Law

United States District Court judges meeting age and longevity of tenure requirements may resign, engage in the practice of law, and continue to receive retirement pay. This retirement pay is not, however, adjusted to reflect changes in the pay of active District Court judges.

Retired Tax Court judges who engage in the practice of Federal tax or contract renegotiation law forfeit all retirement pay. Forfeiture also occurs if a retired Tax Court judge accepts another government position, whether compensated or not.

Explanation of the Bill

The bill would permit Tax Court judges meeting specified age and tenure requirements to elect to receive 60 percent of retired pay (which would be adjusted to reflect changes in the pay of active Tax Court judges) and not be subject to the prohibition on practicing law. The bill would also suspend retired pay for the period of time during which a retired Tax Court judge holds a compensated Government position.

Effective Date

This provision would generally be effective on the date of enactment.

e. Clarification of jurisdiction over penalty for failure to pay tax

Present Law

The Tax Court has held that it does not have jurisdiction over the addition to tax for failure to pay the amount of tax shown on the taxpayer's return, even though it has jurisdiction to redetermine a deficiency in tax with respect to that return (*Est. of Young* v. *Comm'r*, 81 T.C. 879 (1983)).

Explanation of the Bill

The bill would provide that the Tax Court has jurisdiction over this addition to tax for failure to pay an amount shown on the return where the Tax Court already has jurisdiction to redetermine a deficiency in tax with respect to that return.

Effective Date

This provision would be effective for any action or proceeding before the Tax Court with respect to which a decision has not become final before the date of enactment.

10. H.R. 4597—Mr. Rangel (by Request)

BATF Administrative Provisions

Present Law

Registration of certain firearms

Each importer, manufacturer, and dealer in machine guns, destructive devices, and certain other firearms is required to register his business activity with the Bureau of Alcohol, Tobacco, and Firearms (BATF), on first engaging in such business and annually thereafter before the first day of July. Registration is required in each internal revenue district in which business activities are conducted (Code sec. 5802).

In addition, each manufacturer, importer, and maker is required to register each such firearm manufactured, imported, or transferred to another person (sec. 5841). The registration must identify the firearm and the name and address of the person entitled to possession of the firearm. The information is retained in a National Firearms Registration and Transfer Record maintained by BATF as a central registry of such firearms in the United States (other than those in the control of the Federal Government). Owners of firearms must retain proof of the registration.

Forfeiture of unregistered firearms

Unregistered firearms are subject to seizure and forfeiture, under the same rules that govern seizure of property in satisfaction of Federal tax liability (sec. 5872). No firearm that is forfeited because of a violation of Code provisions may be sold at public sale. Rather, forfeited firearms are destroyed, sold to a State or possession, or retained for official use within the Federal Government (sec. 5872). Before disposition, the Government must arrange appropriate storage for the firearm in the Federal judicial district in which the seizure occurred. (Storage within the judicial district in which the seizure occurs is required because jurisdiction over seized firearms is *in rem*, i.e., attaches only to property physically located within the district.)

Firearms subject to these restrictions generally include (1) a shotgun having a barrel less than 18 inches in length; (2) a rifle having a barrel less than 16 inches in length; (3) any other weapon which may be concealed on the person and from which a shot can be discharged; (4) a machine gun; (5) a muffler or silencer for any firearm; and (6) a destructive device, i.e., an explosive, incendiary or poison gas, bomb, grenade, etc., and any weapon, or combination of parts, intended for use as a destructive device (sec. 5845).

Place for filing alcohol, tobacco, and firearms tax returns

Federal excise tax returns, like Federal income tax returns, are filed with Internal Revenue Service Centers or District Offices. No separate rules are provided for the excise taxes administered by BATF. Thus, under present law, the IRS processes returns of the excise taxes on alcohol, tobacco, and firearms before forwarding those returns to BATF.

Annual occupational excise taxes are imposed on importers, manufacturers, and dealers in machine guns, destructive devices, and certain other firearms (sec. 5801). Also, excise taxes are imposed on the transfer or making of such firearms (secs. 5811 and 5821).

Explanation of the Bill

Registration of certain firearms

The bill would permit BATF to establish locations other than internal revenue (IRS) districts (i.e., IRS districts) for registering firearms currently required to be registered. Manufacturers and importers of firearms required to register with BATF would be required to register in each State in which they conducted business activities.

Forfeiture of unregistered firearms

The bill would provide that if a firearm required to be registered is not so registered and is seized by the United States, no property rights would exist in the firearm. In addition, the general rules on judicial and administrative actions (secs. 7323 and 7325) to enforce forfeiture would not apply to unregistered firearms seized by the Government. Thus, the Government would not be required to take judicial or administrative action to effect forfeiture of firearms that are not registered as required under the Code.

Within one year after summary forfeiture of an unregistered firearm, the owner could apply to the Treasury Department for reimbursement of the value of the property. Reimbursement would be made only if it were established that the firearm had not been used in a violation of law, or that any such unlawful use had occurred without the owner's consent or knowledge.

In addition, the bill would permit the Treasury Department to store seized firearms outside of the judicial district in which the seizure occurred pending their disposition. Such storage outside the judicial district would not affect the jurisdiction of the court with jurisdiction over the property.

Place for filing alcohol, tobacco, and firearms tax returns

The bill would amend the rules governing filing of excise tax returns to specifically authorize BATF to prescribe locations for filing returns related to the alcohol, tobacco, and firearms different from the filing requirements for returns of taxes administered by the IRS.

Effective Date

The provisions on registration of certain firearms would be effective on July 1, 1987; the new rules on forfeiture of firearms required to be registered would apply to firearms seized after the date of enactment.

The provisions on filing of returns of the excise taxes on alcohol, tobacco, and firearms would take effect on the first day of the first month beginning more than 90 days after enactment.

11. H.R. 4603—Mr. Hubbard

Hazardous Substance Removal Costs Treated as Qualifying Distributions for a Private Foundation

Present Law

To avoid "penalty" excise taxes under Code section 4942, a private grantmaking foundation must make qualifying distributions, by the end of the following year, at least equal to the distributable amount computed for the current year. This amount equals five percent of the fair market value of the foundation's investment assets for the year, reduced by the amount of section 4940 excise tax on the foundation's net investment income.

The term qualifying distribution means any amount paid to accomplish a charitable, educational, etc. purpose as described in section 170(c)(2)(B), subject to certain exceptions, or to acquire assets used directly in carrying out such charitable purposes (sec. 4942(g)(1)). The payout requirement can be satisfied either by direct expenditures to accomplish charitable purposes or by grants to public charities or private operating foundations. If certain requirements are met, a foundation may treat as current distributions amounts set aside to be paid within five years for a specific project.

Explanation of the Bill

The effect of the bill would be to reduce the otherwise applicable distributable amount for the James Graham Brown Foundation, Inc., by the amount of expenditures paid, incurred, or set aside by that Foundation for investigatory costs and direct costs of removal or taking remedial action with respect to hazardous substances at the site of a facility transferred to the Foundation by bequest (before December 11, 1980) and operated by the Foundation (where operation ceased before December 12, 1980).

Effective Date

The bill would apply retroactively to taxable years beginning after 1982.

Other Congressional Action

An identical provision is included as a Senate amendment to the Superfund legislation (H.R. 2005) currently in conference.