TECHNICAL EXPLANATION OF CERTAIN REVENUE PROVISIONS OF THE WORKER, HOMEOWNERSHIP, AND BUSINESS ASSISTANCE ACT OF 2009

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of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of certain revenue provisions of The Worker, Homeownership, and Business Assistance Act of 2009.[2]

[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of Certain Revenue Provisions of the Worker, Homeownership, and Business Assistance Act of 2009* (JCX-44-09), November 3, 2009. This document can also be found on our website at www.jct.gov.

[2] Except as otherwise noted, all references to sections in this document are to sections of the Internal Revenue Code of 1986 ("the Code"), as amended.

A. Extension and Modification of First-Time Homebuyer Credit (secs. 11 and 12 of the bill and sec. 36 of the Code)

Present Law

In general

An individual who is a first-time homebuyer is allowed a refundable tax credit equal to the lesser of $8,000 ($4,000 for a married individual filing separately) or 10 percent of the purchase price of a principal residence. The credit is allowed for qualifying home purchases on or after April 9, 2008, and before December 1, 2009.[3]

The credit phases out for individual taxpayers with modified adjusted gross income between $75,000 and $95,000 ($150,000 and $170,000 for joint filers) for the year of purchase.

An individual is considered a first-time homebuyer if the individual had no ownership interest in a principal residence in the United States during the 3-year period prior to the purchase of the home.

An election is provided to treat a residence purchased after December 31, 2008, and before December 1, 2009, as purchased on December 31, 2008, so that the credit may be claimed on the 2008 income tax return.

No District of Columbia first-time homebuyer credit[4] is allowed to any taxpayer with respect to the purchase of a residence after December 31, 2008, and before December 1, 2009, if the national first-time homebuyer credit is allowable to such taxpayer (or the taxpayer's spouse) with respect to such purchase.

Recapture

For homes purchased on or before December 31, 2008, the credit is recaptured ratably over fifteen years with no interest charge beginning in the second taxable year after the taxable year in which the home is purchased. For example, if an individual purchases a home in 2008, recapture commences with the 2010 tax return. If the individual sells the home (or the home ceases to be used as the principal residence of the individual or the individual's spouse) prior to complete recapture of the credit, the amount of any credit not previously recaptured is due on the tax return for the year in which the home is sold (or ceases to be used as the principal residence).[5] However, in the case of a sale to an unrelated person, the amount recaptured may not exceed the amount of gain from the sale of the residence. For this purpose, gain is

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[3] For purchases before January 1, 2009, the dollar limits are $7,500 ($3,750 for a married individual filing separately).

[4] Sec. 1400C.

[5] If the individual sells the home (or the home ceases to be used as the principal residence of the individual and the individual's spouse) in the same taxable year the home is purchased, no credit is allowed.

determined by reducing the basis of the residence by the amount of the credit to the extent not previously recaptured. No amount is recaptured after the death of an individual. In the case of an involuntary conversion of the home, recapture is not accelerated if a new principal residence is acquired within a two-year period. In the case of a transfer of the residence to a spouse or to a former spouse incident to divorce, the transferee spouse (and not the transferor spouse) will be responsible for any future recapture. Recapture does not apply to a home purchased after December 31, 2008 that is treated (at the election of the taxpayer) as purchased on December 31, 2008.

For homes purchased after December 31, 2008, and before December 1, 2009, the credit is recaptured only if the taxpayer disposes of the home (or the home otherwise ceases to be the principal residence of the taxpayer) within 36 months from the date of purchase.

Explanation of Provision

Extension of application period

In general, the credit is extended to apply to a principal residence purchased by the taxpayer before May 1, 2010. The credit applies to the purchase of a principal residence before July 1, 2010 by any taxpayer who enters into a written binding contract before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010.

The waiver of recapture, except in the case of disposition of the home (or the home otherwise ceases to be the principal residence of the taxpayer) within 36 months from the date of purchase, is extended to any purchase of a principal residence after December 31, 2008.

The election to treat a purchase as occurring in a prior year is modified. In the case of a purchase of a principal residence after December 31, 2008, a taxpayer may elect to treat the purchase as made on December 31 of the calendar year preceding the purchase for purposes of claiming the credit on the prior year's tax return.

No District of Columbia first-time homebuyer credit[6] is allowed to any taxpayer with respect to the purchase of a residence after December 31, 2008, if the national first-time homebuyer credit is allowable to such taxpayer (or the taxpayer's spouse) with respect to such purchase.

Long-time residents of the same principal residence

An individual (and, if married, the individual's spouse) who has maintained the same principal residence for any five-consecutive year period during the eight-year period ending on the date of the purchase of a subsequent principal residence is treated as a first-time homebuyer. The maximum allowable credit for such taxpayers is $6,500 ($3,250 for a married individual filing separately).

[6] Sec. 1400C.

Limitations

The bill raises the income limitations to qualify for the credit. The credit phases out for individual taxpayers with modified adjusted gross income between $125,000 and $145,000 ($225,000 and $245,000 for joint filers) for the year of purchase.

No credit is allowed for the purchase of any residence if the purchase price exceeds $800,000.

No credit is allowed unless the taxpayer is 18 years of age as of the date of purchase. A taxpayer who is married is treated as meeting the age requirement if the taxpayer or the taxpayer's spouse meets the age requirement.

The definition of purchase excludes property acquired from a person related to the person acquiring such property or the spouse of the person acquiring the property, if married.

No credit is allowed to any taxpayer if the taxpayer is a dependent of another taxpayer.

No credit is allowed unless the taxpayer attaches to the relevant tax return a properly executed copy of the settlement statement used to complete the purchase.

Waiver of recapture for individuals on qualified official extended duty

In the case of a disposition of principal residence by an individual (or a cessation of use of the residence that otherwise would cause recapture) after December 31, 2008, in connection with Government orders received by the individual (or the individual's spouse) for qualified official extended duty service, no recapture applies by reason of the disposition of the residence,[7] and any 15-year recapture with respect to a home acquired before January 1, 2009, ceases to apply in the taxable year the disposition occurs.

Qualified official extended duty service means service on official extended duty as a member of the uniformed services, a member of the Foreign Service of the United States, or an employee of the intelligence community.[8]

Qualified official extended duty is any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

[7] If the individual sells the home (or the home ceases to be used as the principal residence of the individual and the individual's spouse) in connection with such orders in the same taxable year the home is purchased, the credit is allowable.

[8] These terms have the same meaning as under the provision for exclusion of gain on the sale of certain principal residences. Sec. 121.

The uniformed services include: (1) the Armed Forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service.

The term "member of the Foreign Service of the United States" includes: (1) chiefs of mission; (2) ambassadors at large; (3) members of the Senior Foreign Service; (4) Foreign Service officers; and (5) Foreign Service personnel.

The term "employee of the intelligence community" means an employee of the Office of the Director of National Intelligence, the Central Intelligence Agency, the National Security Agency, the Defense Intelligence Agency, the National Geospatial-Intelligence Agency, or the National Reconnaissance Office. The term also includes employment with: (1) any other office within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs; (2) any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation, the Department of the Treasury, the Department of Energy, and the Coast Guard; (3) the Bureau of Intelligence and Research of the Department of State; and (4) the elements of the Department of Homeland Security concerned with the analyses of foreign intelligence information.

Extension of the first-time homebuyer credit for individuals on qualified official extended duty outside of the United States

In the case of any individual (and, if married, the individual's spouse) who serves on qualified official extended duty service outside of the United States for at least 90 days during the period beginning after December 31, 2008, and ending before May 1, 2010, the expiration date of the first-time homebuyer credit is extended for one year, through May 1, 2011 (July 1, 2011, in the case of an individual who enters into a written binding contract before May 1, 2011, to close on the purchase of a principal residence before July 1, 2011).

Mathematical error authority

The bill makes a number of changes to expand the definition of mathematical or clerical error for purposes of administration of the credit by the Internal Revenue Service ("IRS"). The IRS may assess additional tax without issuance of a notice of deficiency as otherwise required[9] in the case of: an omission of any increase in tax required by the recapture provisions of the credit; information from the person issuing the taxpayer identification number of the taxpayer that indicates that the taxpayer does not meet the age requirement of the credit; information provided to the Secretary by the taxpayer on an income tax return for at least one of the two preceding taxable years that is inconsistent with eligibility for such credit; or, failure to attach to the return a properly executed copy of the settlement statement used to complete the purchase.

[9] Sec. 6213.

Effective Date

The extension of the first-time homebuyer credit and coordination with the first-time homebuyer credit for the District of Columbia apply to residences purchased after November 30, 2009.

Provisions relating to long-time residents of the same principal residence, and income, purchase price, age, related party, dependent, and documentation limitations apply for purchases after the date of enactment.

The waiver of recapture provision applies to dispositions and cessations after December 31, 2008.

The expansion of mathematical and clerical error authority applies to returns for taxable years ending on or after April 9, 2008.

B. Five-Year Carryback of Operating Losses (sec. 13 of the bill and sec. 172 of the Code)

Present Law

In general

Under present law, a net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[10] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[11]

For purposes of computing the alternative minimum tax ("AMT"), a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than 90 percent of the AMTI.[12]

In the case of a life insurance company, present law allows a deduction for the operations loss carryovers and carrybacks to the taxable year, in lieu of the deduction for net operation losses allowed to other corporations.[13] A life insurance company is permitted to treat a loss from operations (as defined under section 810(c)) for any taxable year as an operations loss carryback to each of the three taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.[14]

Temporary rule for small business

Present law provides an eligible small business with an election[15] to increase the present-law carryback period for an "applicable 2008 NOL" from two years to any whole number of years elected by the taxpayer that is more than two and less than six. An eligible small business is a taxpayer meeting a $15,000,000 gross receipts test. An applicable 2008 NOL is the taxpayer's NOL for any taxable year ending in 2008, or if elected by the taxpayer, the NOL for any taxable year beginning in 2008. However, any election under this provision may be made only with respect to one taxable year.

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[10] Sec. 172(b)(1)(A). Different carryback periods apply with respect to NOLs arising in certain special circumstances.

[11] Sec. 172(b)(2).

[12] Sec. 56(d).

[13] Secs. 810, 805(a)(5).

[14] Sec. 810(b)(1).

[15] Sec. 172(b)(1)(H).

Explanation of Provision

The provision provides an election[16] to increase the present-law carryback period for an applicable NOL from two years to any whole number of years elected by the taxpayer which is more than two and less than six. An applicable NOL is the taxpayer's NOL for a taxable year beginning or ending in either 2008 or 2009. Generally, a taxpayer may elect an extended carryback period for only one taxable year.

The amount of an NOL that may be carried back to the fifth taxable year preceding the loss year is limited to 50 percent of taxable income for such taxable year (computed without regard to the NOL for the loss year or any taxable year thereafter).[17] The limitation does not apply to the applicable 2008 NOL of an eligible small business with respect to which an election is made (either before or after the date of enactment of the bill) under the provision as presently in effect. The amount of the NOL otherwise carried to taxable years subsequent to such fifth taxable year is to be adjusted to take into account that the NOL could offset only 50 percent of the taxable income in such year. Thus, in determining the excess of the applicable NOL over the sum of the taxpayer's taxable income for each of the prior taxable years to which the loss may be carried, only 50 percent of the taxable income for the taxable year for which the limitation applies is to be taken into account.

The provision also suspends the 90-percent limitation on the use of any alternative tax NOL deduction attributable to carrybacks of the applicable NOL for which an extended carryback period is elected.[18]

For life insurance companies, the provision provides an election to increase the present-law carryback period for an applicable loss from operations from three years to four or five years. An applicable loss from operations is the taxpayer's loss from operations for any taxable year beginning or ending in either 2008 or 2009. A 50-percent of taxable income limitation applies to the fifth taxable year preceding the loss year.

A taxpayer must make the election by the extended due date for filing the return for the taxpayer's last taxable year beginning in 2009, and in such manner as may be prescribed by the Secretary.[19] An election, once made, is irrevocable.

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[16] For all elections under this provision, the common parent of a group of corporations filing a consolidated return makes the election, which is binding on all such corporations.

[17] The taxable income limitation only applies to that portion of an applicable NOL that is carried back to the fifth preceding taxable year under subparagraph (H) of section 172(b)(1). The limitation does not apply to the portion of the loss carried back under another subparagraph of section 172(b)(1), such as a specified liability loss, farming loss, or qualified disaster loss.

[18] It is intended that in applying the 50-percent taxable income limitation with respect to the carryback of an alternative tax NOL deduction to the fifth preceding taxable year, the limitation is applied separately based on alternative minimum taxable income.

[19] It is anticipated that the procedures for making the election will be substantially similar to those prescribed for eligible small businesses under present law. See Rev. Proc. 2009-26, 2009-19 I.R.B. 935.

An eligible small business that timely made (or timely makes) an election under the provision as in effect on the day before the enactment of the bill to carryback its applicable 2008 NOL may also elect to carryback a 2009 NOL under the amended provision.[20] It is intended that an eligible small business may continue to make the present-law election under procedures prescribed in Rev. Proc. 2009-26 following the enactment of the bill.

The provision generally does not apply to: (1) any taxpayer if (a) the Federal government acquired or acquires at any time,[21] an equity interest in the taxpayer pursuant to the Emergency Economic Stabilization Act of 2008,[22] or (b) the Federal government acquired or acquires, at any time, any warrant (or other right) to acquire any equity interest with respect to the taxpayer pursuant to such Act; (2) the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation; and (3) any taxpayer that in 2008 or 2009[23] is a member of the same affiliated group (as defined in section 1504 without regard to subsection (b) thereof) as a taxpayer to which the provision does not otherwise apply. An equity interest (or right to acquire an equity interest) is disregarded for this purpose if acquired by the Federal government after the date of enactment from a financial institution[24] pursuant to a program established by the Secretary for the stated purpose of increasing the availability of credit to small businesses using funding made available under the Emergency Economic Stabilization Act of 2008.

Effective Date

The provision is generally effective for net operating losses arising in taxable years ending after December 31, 2007. The modification to the alternative tax NOL deduction applies to taxable years ending after December 31, 2002. The modification with respect to operating loss deductions of life insurance companies applies to losses from operations arising in taxable years ending after December 31, 2007.

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[20] Present law section 172(b)(1)(H)(iii) provides that an eligible small business must make the election by the extended due date for filing its return for the taxable year of the net operating loss. An eligible small business that did not (or does not) timely elect to carryback its applicable 2008 NOL under present law is subject to the general provision (i.e., election available for either 2008 or 2009 NOL and 50 percent of taxable income limitation applies for the 5th taxable year preceding the loss year).

[21] For example, if the Federal government acquires an equity interest in the taxpayer during 2010, or in later years, the taxpayer is not entitled to the extended carryback rules under this provision. If the carryback has previously been claimed, amended filings may be necessary to reflect this disallowance. Additionally, if the Federal government acquired an equity interest in the taxpayer pursuant to the Emergency Economic Stabilization Act of 2008 and the taxpayer has repaid that investment, it is not entitled to the extended carryback rules under this provision.

[22] Pub. L. No. 110-343.

[23] For example, a taxpayer with an NOL in 2008 that in 2009 joins an affiliated group with a member in which the Federal government has acquired an equity interest pursuant to the Emergency Economic Stabilization Act of 2008 may not utilize the extended carryback rules under this provision with regard to the 2008 NOL. The taxpayer is required to amend prior filings to reflect the permitted carryback period.

[24] As defined in section 3 of the Emergency Economic Stabilization Act of 2008.

Under transition rules, a taxpayer may revoke any election to waive the carryback period under either section 172(b)(3) or section 810(b)(3) with respect to an applicable NOL or an applicable loss from operations for a taxable year ending before the date of enactment by the extended due date for filing the tax return for the taxpayer's last taxable year beginning in 2009. Similarly, any application for a tentative carryback adjustment under section 6411(a) with respect to such loss is treated as timely filed if filed by the extended due date for filing the tax return for the taxpayer's last taxable year beginning in 2009.

C. Exclusion from Gross Income of Qualified Military Base Realignment and Closure Fringe (sec. 14 of the bill and sec. 132 of the Code)

Present Law

Homeowners Assistance Program payment

The Department of Defense Homeowners Assistance Program ("HAP") provides payments to certain employees and members of the Armed Forces to offset the adverse effects on housing values that result from a military base realignment or closure.

In general, under the HAP, eligible individuals receive either: (1) a cash payment as compensation for losses that may be or have been sustained in a private sale, in an amount not to exceed the difference between (a) 95 percent of the fair market value of their property prior to public announcement of intention to close all or part of the military base or installation and (b) the fair market value of such property at the time of the sale; or (2) as the purchase price for their property, an amount not to exceed 90 percent of the prior fair market value as determined by the Secretary of Defense, or the amount of the outstanding mortgages.

The American Recovery and Reinvestment Act of 2009[25] expands the HAP in various ways. It amends the Demonstration Cities and Metropolitan Development Act of 1966[26] to allow, under the HAP under such Act, the Secretary of Defense to provide assistance or reimbursement for certain losses in the sale of family dwellings by members of the Armed Forces living on or near a military installation in situations where: (1) there was a base closure or realignment; (2) the property was purchased before July 1, 2006, and sold between that date and September 30, 2012; (3) the property is the owner's primary residence; and (4) the owner has not previously received benefits under the HAP. Further, it authorizes similar HAP assistance or reimbursement with respect to: (1) wounded members and wounded civilian Department of Defense and Coast Guard employees (and their spouses); and (2) members permanently reassigned from an area at or near a military installation to a new duty station more than 50 miles away (with similar purchase and sale date, residence, and no-previous-benefit requirements as above). It allows the Secretary to provide compensation for losses from home sales by such individuals to ensure the realization of at least 90 percent (in some cases, 95 percent) of the pre-mortgage-crisis assessed value of such property.

Tax treatment

Present law generally excludes from gross income amounts received under the HAP (as in effect on November 11, 2003).[27] Amounts received under the program also are not considered

[25] Pub. L. No. 111-5.

[26] Pub. L. No. 89-754, 42 U.S.C. 3374.

[27] Sec. 132(n).

wages for FICA tax purposes (including Medicare). The excludable amount is limited to the reduction in the fair market value of property.

Explanation of Provision

The bill expands the exclusion to HAP payments authorized under the American Recovery and Reinvestment Tax Act of 2009.

Effective Date

The provision is effective for payments made after February 17, 2009 (the date of enactment of the American Recovery and Reinvestment Tax Act of 2009).

D. Delay in Application of Worldwide Allocation of Interest (sec. 15 of the bill and sec. 864 of the Code)

Present Law

In general

To compute the foreign tax credit limitation, a taxpayer must determine the amount of its taxable income from foreign sources. Thus, the taxpayer must allocate and apportion deductions between items of U.S.-source gross income, on the one hand, and items of foreign-source gross income, on the other.

In the case of interest expense, the rules generally are based on the approach that money is fungible and that interest expense is properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring an obligation on which interest is paid.[28] For interest allocation purposes, all members of an affiliated group of corporations generally are treated as a single corporation (the so-called "one-taxpayer rule") and allocation must be made on the basis of assets rather than gross income. The term "affiliated group" in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns.

For consolidation purposes, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation that is an includible corporation, but only if: (1) the common parent owns directly stock possessing at least 80 percent of the total voting power and at least 80 percent of the total value of at least one other includible corporation; and (2) stock meeting the same voting power and value standards with respect to each includible corporation (excluding the common parent) is directly owned by one or more other includible corporations.

Generally, the term "includible corporation" means any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation.

Subject to exceptions, the consolidated return and interest allocation definitions of affiliation generally are consistent with each other.[29] For example, both definitions generally exclude all foreign corporations from the affiliated group. Thus, while debt generally is

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[28] However, exceptions to the fungibility principle are provided in particular cases, some of which are described below.

[29] One such exception is that the affiliated group for interest allocation purposes includes section 936 corporations (certain electing domestic corporations that have income from the active conduct of a trade or business in Puerto Rico or another U.S. possession) that are excluded from the consolidated group.

considered fungible among the assets of a group of domestic affiliated corporations, the same rules do not apply as between the domestic and foreign members of a group with the same degree of common control as the domestic affiliated group.

Banks, savings institutions, and other financial affiliates

The affiliated group for interest allocation purposes generally excludes what are referred to in the Treasury regulations as "financial corporations."[30] A financial corporation includes any corporation, otherwise a member of the affiliated group for consolidation purposes, that is a financial institution (described in section 581 or section 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by State or Federal law to be operated separately from any other entity that is not a financial institution.[31] The category of financial corporations also includes, to the extent provided in regulations, bank holding companies (including financial holding companies), subsidiaries of banks and bank holding companies (including financial holding companies), and savings institutions predominantly engaged in the active conduct of a banking, financing, or similar business.[32]

A financial corporation is not treated as a member of the regular affiliated group for purposes of applying the one-taxpayer rule to other non-financial members of that group. Instead, all such financial corporations that would be so affiliated are treated as a separate single corporation for interest allocation purposes.

Worldwide interest allocation

In general

The American Jobs Creation Act of 2004 ("AJCA")[33] modified the interest expense allocation rules described above (which generally apply for purposes of computing the foreign tax credit limitation) by providing a one-time election (the "worldwide affiliated group election") under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally is determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis (i.e., as if all members of the worldwide group were a single corporation). If a group makes this election, the taxable income of the domestic members of a worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the third-party interest expense of those domestic members to foreign-source income in an amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide third-party interest expense multiplied

[30] Treas. Reg. sec. 1.861-11T(d)(4).

[31] Sec. 864(e)(5)(C).

[32] Sec. 864(e)(5)(D).

[33] Pub. L. No. 108-357, sec. 401.

by the ratio that the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated group,[34] over (2) the third-party interest expense incurred by foreign members of the group to the extent such interest would be allocated to foreign sources if the principles of worldwide interest allocation were applied separately to the foreign members of the group.[35]

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group as well as all controlled foreign corporations that, in the aggregate, either directly or indirectly,[36] would be members of such an affiliated group if section 1504(b)(3) did not apply (i.e., in which at least 80 percent of the vote and value of the stock of such corporations is owned by one or more other corporations included in the affiliated group). Thus, if an affiliated group makes this election, the taxable income from sources outside the United States of domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group, as modified to include insurance companies) and certain controlled foreign corporations were attributable to a single corporation.

Financial institution group election

Taxpayers are allowed to apply the bank group rules to exclude certain financial institutions from the affiliated group for interest allocation purposes under the worldwide fungibility approach. The rules also provide a one-time "financial institution group" election that expands the bank group. At the election of the common parent of the pre-election worldwide affiliated group, the interest expense allocation rules are applied separately to a subgroup of the worldwide affiliated group that consists of (1) all corporations that are part of the bank group, and (2) all "financial corporations." For this purpose, a corporation is a financial corporation if at least 80 percent of its gross income is financial services income (as described in section 904(d)(2)(C)(i) and the regulations thereunder) that is derived from transactions with unrelated persons.[37] For these purposes, items of income or gain from a transaction or series of transactions are disregarded if a principal purpose for the transaction or transactions is to qualify any corporation as a financial corporation.

[34] For purposes of determining the assets of the worldwide affiliated group, neither stock in corporations within the group nor indebtedness (including receivables) between members of the group is taken into account.

[35] Although the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return.

[36] Indirect ownership is determined under the rules of section 958(a)(2) or through applying rules similar to those of section 958(a)(2) to stock owned directly or indirectly by domestic partnerships, trusts, or estates.

[37] See Treas. Reg. sec. 1.904-4(e)(2).

In addition, anti-abuse rules are provided under which certain transfers from one member of a financial institution group to a member of the worldwide affiliated group outside of the financial institution group are treated as reducing the amount of indebtedness of the separate financial institution group. Regulatory authority is provided with respect to the election to provide for the direct allocation of interest expense in circumstances in which such allocation is appropriate to carry out the purposes of these rules, to prevent assets or interest expense from being taken into account more than once, or to address changes in members of any group (through acquisitions or otherwise) treated as affiliated under these rules.

Effective date of worldwide interest allocation

The common parent of the domestic affiliated group must make the worldwide affiliated group election. It must be made for the first taxable year beginning after December 31, 2010, in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group.[38] The common parent of the pre-election worldwide affiliated group must make the election for the first taxable year beginning after December 31, 2010, in which a worldwide affiliated group includes a financial corporation. Once either election is made, it applies to the common parent and all other members of the worldwide affiliated group or to all members of the financial institution group, as applicable, for the taxable year for which the election is made and all subsequent taxable years, unless revoked with the consent of the Secretary of the Treasury.

Phase-in rule

HERA also provided a special phase-in rule in the case of the first taxable year to which the worldwide interest allocation rules apply. For that year, the amount of the taxpayer's taxable income from foreign sources is reduced by 70 percent of the excess of (i) the amount of its taxable income from foreign sources as calculated using the worldwide interest allocation rules over (ii) the amount of its taxable income from foreign sources as calculated using the present-law interest allocation rules. For that year, the amount of the taxpayer's taxable income from domestic sources is increased by a corresponding amount. Any foreign tax credits disallowed by virtue of this reduction in foreign-source taxable income may be carried back or forward under the normal rules for carrybacks and carryforwards of excess foreign tax credits.

Explanation of Provision

The provision delays the effective date of worldwide interest allocation rules for seven years, until taxable years beginning after December 31, 2017. The required dates for making the worldwide affiliated group election and the financial institution group election are changed accordingly.

[38] As originally enacted under AJCA, the worldwide interest allocation rules were effective for taxable years beginning after December 31, 2008. However, the Housing and Economic Recovery Act of 2008 ("HERA") delayed the implementation of the worldwide interest allocation rules for two years, until taxable years beginning after December 31, 2010. Pub. L. No. 110-289, sec. 3093.

The provision also eliminates the special phase-in rule that applies in the case of the first taxable year to which the worldwide interest allocation rules apply.

Effective Date

The provision is effective for taxable years beginning after December 31, 2010.

E. Modification of Penalty for Failure to File Partnership or S Corporation Returns (sec. 16 of the bill and secs. 6698 and 6699 of the Code)

Present Law

Both partnerships and S corporations are generally treated as pass-through entities that do not incur an income tax at the entity level. Income earned by a partnership, whether distributed or not, is taxed to the partners. Distributions from the partnership generally are tax-free. The items of income, gain, loss, deduction or credit of a partnership generally are taken into account by a partner as allocated under the terms of the partnership agreement. If the agreement does not provide for an allocation, or the agreed allocation does not have substantial economic effect, then the items are to be allocated in accordance with the partners' interests in the partnership. To prevent double taxation of these items, a partner's basis in its interest is increased by its share of partnership income (including tax-exempt income), and is decreased by its share of any losses (including nondeductible losses). An S corporation generally is not subject to corporate-level income tax on its items of income and loss. Instead, the S corporation passes through its items of income and loss to its shareholders. The shareholders take into account separately their shares of these items on their individual income tax returns.

Under present law, both partnerships and S corporations are required to file tax returns for each taxable year.[39] The partnership's tax return is required to include the names and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual. The S corporation's tax return is required to include the following: the names and addresses of all persons owning stock in the corporation at any time during the taxable year; the number of shares of stock owned by each shareholder at all times during the taxable year; the amount of money and other property distributed by the corporation during the taxable year to each shareholder and the date of such distribution; each shareholder's pro rata share of each item of the corporation for the taxable year; and such other information as the Secretary may require.

In addition to applicable criminal penalties, present law imposes assessable civil penalties for both the failure to file a partnership return and the failure to file an S corporation return.[40] Each of these penalties is currently $89 times the number of shareholders or partners for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months for returns required to be filed after December 31, 2008.

Explanation of Provision

Under the provision, the base amount on which a penalty is computed for a failure with respect to filing either a partnership or S corporation return is increased to $195 per partner or shareholder.

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[39] Secs. 6031 and 6037, respectively.

[40] Secs. 6698 and 6699, respectively.

Effective Date

The provision applies to returns for taxable years beginning after December 31, 2009.

F. Expansion of Electronic Filing by Return Preparers (sec. 17 of the bill and sec. 6011(e) of the Code)

Present Law

The IRS Restructuring and Reform Act of 1998[41] ("RRA 1998") states a Congressional policy to promote the paperless filing of Federal tax returns. Section 2001(a) of RRA 1998 sets a goal for the IRS to have at least 80 percent of all Federal tax and information returns filed electronically by 2007. Section 2001(b) of RRA 1998 requires the IRS to establish a 10-year strategic plan to eliminate barriers to electronic filing.

Present law authorizes the IRS to issue regulations specifying which returns must be filed electronically.[42] There are several limitations on this authority. First, it can only apply to persons required to file at least 250 returns during the calendar year.[43] Second, the Secretary is prohibited from requiring that income tax returns of individuals, estates, and trusts be submitted in any format other than paper, although these returns may be filed electronically by choice.

Regulations require corporations and tax-exempt organizations that have assets of $10 million or more and file at least 250 returns during a calendar year, including income tax, information, excise tax, and employment tax returns, to file electronically their Form 1120/1120S income tax returns and Form 990 information returns for tax years ending on or after December 31, 2006.[44] Private foundations and charitable trusts that file at least 250 returns during a calendar year are required to file electronically their Form 990-PF information returns for tax years ending on or after December 31, 2006, regardless of their asset size. Taxpayers can request waivers of the electronic filing requirement if they cannot meet that requirement due to technological constraints, or if compliance with the requirement would result in undue financial burden on the taxpayer.

Explanation of Provision

The provision generally maintains the current rule that regulations may not require any person to file electronically unless the person files at least 250 tax returns during the calendar year. However, the proposal provides an exception to this rule and mandates that the Secretary require electronic filing by specified tax return preparers. "Specified tax return preparers" are all return preparers except those who neither prepare nor reasonably expect to prepare ten or more individual income tax returns in a calendar year. The term "individual income tax return" is defined to include returns for estates and trusts as well as individuals.

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[41] Pub. L. No. 105-206.

[42] Sec. 6011(e).

[43] Partnerships with more than 100 partners are required to file electronically. Sec. 6011(e)(2).

[44] Treas. Reg. secs. 301.6011-5, 301.6033-4 and 301.6037-2.

Effective Date

The provision is effective for tax returns filed after December 31, 2010.

G. Time for Payment of Corporate Estimated Taxes (sec. 18 of the bill and sec. 6655 of the Code)

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability.[45] For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15. In the case of a corporation with assets of at least $1 billion (determined as of the end of the preceding tax year), payments due in July, August, or September, 2014, are increased to 100.25 percent of the payment otherwise due and the next required payment is reduced accordingly.[46]

Explanation of Provision

The provision increases the required payment of estimated tax otherwise due in July, August, or September, 2014, by 33 percentage points.

Effective Date

The provision is effective on the date of the enactment of this Act.

[45] Sec. 6655.

[46] Pub. L. No. 111-42, sec. 202(b)(1).