RSC Republican Study Committee
Rep. Sue Myrick (R-NC), Chairman
230 Cannon House Office Building
Washington, D.C. 20515
ph (202) 226-9717 / fax (202) 226-1633

Legislative Bulletin……………………………….………June 17, 2004

Contents:

H.R. 4520—American Jobs Creation Act (FSC-ETI) (Thomas)

Order of Business: The bill is scheduled to be considered on Thursday, June 17th, subject to a closed rule (H.Res. 681). The rule would automatically adopt a Rep. Thomas (Manager's) Amendment into the base bill (included in summary below). The Senate passed its version of this bill (S. 1637) by a vote of 92-5 on May 11, 2004.

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718

Summary: In short, H.R. 4520 would repeal the Foreign Sales Corporation/ Extraterritorial Income (FSC/ETI) tax regime for American exporters, which was ruled an illegal export subsidy by the World Trade Organization (in a complaint brought by the European Union). *[See "Additional Background" section below for an explanation of what the FSC/ETI regime is.]* Since this repeal would serve as a tax increase, the increase is offset with cuts in the corporate tax rates and tax incentives for domestic manufacturers, producers, farmers, and small corporations. The bill contains numerous tax eliminations and simplifications.

In addition, the bill would allow taxpayers to deduct their state and local sales tax from their federal income taxes in 2004 and 2005, extend various expiring tax provisions, and terminate the government's tobacco support program. Note: the safe-harbor-for-churches provision, which was supposedly included to satisfy requests from Rep. Walter Jones (although he opposed the provision as written), is no longer included in the bill.

Highlights, as amended in the Ways & Means Committee and by the Rule: Below are summaries of the major (or otherwise interesting) provisions in the bill.

ETI Phase-out and Repeal. Fully repeals as of 2007 the ETI exclusion of foreign trading gross receipts from gross income for tax purposes. For transactions prior to 2005, taxpayers would retain 100% of their ETI benefits. Taxpayers would retain 80% of their otherwise-applicable ETI benefits for transactions during 2005 and 60% of their otherwise-applicable ETI benefits for transactions during 2006. ETI exclusion provisions would remain in effect for transactions in the ordinary course of a trade or business if such transactions are pursuant to a binding contract (in effect since January 14, 2002) between the taxpayer and an unrelated person.

Corporate Tax Rate Reduction. Reduces the maximum corporate tax rate on "qualified [domestic] production activities income" from 35% to 34% through December 31, 2006, and to 32% beginning January 1, 2007.

Small Corporation Tax Rate Reduction. Gradually reduces certain marginal tax rates for small corporations, as follows.

Current law:

Taxable income:	Income tax rate:
$0 - $50,000	15% of taxable income
$50,001 - $75,000	25% of taxable income
$75,001 - $10,000,000	34% of taxable income
Over $10,000,000	35% of taxable income

Rate schedule applicable in 2013 and thereafter:

Taxable income:	Income tax rate:
$0 - $50,000	15% of taxable income
$50,001 - $75,000	25% of taxable income
$75,001 - $20,000,000	32% of taxable income
Over $20,000,000	35% of taxable income

Section 179 Expensing for Small Businesses. Extends the maximum $100,000 deduction for small business expensing for two years (through December 31, 2007) and extends the $400,000 definition of "small business" for the same timeframe. Without such action, starting in 2006 the section 179 small business expensing cap will decrease from $100,000 to $25,000, and the definition of a small business will decrease from $400,000 to $200,000.

S Corporations. An S corporation is not subject to corporate-level income tax on gains and losses. Instead, an S corporation passes through its gains and losses to its shareholders. The shareholders take into account separately their shares of these items on their individual income tax returns.

The bill would provide that all family members can elect to be treated as one shareholder for purposes of determining the number of shareholders in a S corporation and would increase the number of eligible shareholders from 75 to 100. Further, an IRA (including a Roth IRA) could be a shareholder of a bank that is an S corporation, subject to certain limitations.

Includes several other tax-relief and tax-simplification provisions for S Corporations.

Corporate Alternative Minimum Tax (AMT). Repeals the 90% limitation on the use of the AMT foreign tax credit, thereby allowing the foreign tax credit to fully offset tax liability under the AMT beginning in 2005. Increases from $7.5 million to $20 million the average gross receipts of a corporation (over three years) that would make a corporation exempt from the AMT beginning in 2006. Coordinates farmers' income averaging with the AMT.

Ethanol. Extends the ethanol subsidy through 2010, eliminates the General Fund retention of certain taxes on alcohol fuels, and credits these taxes to the Highway Trust Fund (thereby increasing highway funding for farm states).

Stock Options. Excludes from wages (and thus shields from payroll taxes) incentive stock options and employee stock purchase plan stock options.

Repatriated Income. Makes certain dividends received by a U.S. corporation from its overseas operations (and reinvested in the U.S.) almost fully tax-deductible, subject to a variety of conditions.

Bows, Arrows, Tackle Boxes, and Sonar. Reduces the number of bows subject to the federal excise tax, implements an excise tax on finished arrows (instead of on arrow parts), repeals the excise tax on fishing tackle boxes, and repeals the excise tax on sonar devices for finding fish (all provisions effective starting in 2005).

Distilled Spirits. Creates a new income tax credit for eligible wholesale distributors of domestically bottled distilled spirits. Suspends from July 1, 2004 to June 30, 2007 the special occupational taxes (which can be up to $1000 per year, per premise) imposed on producers and others engaged in the marketing of distilled spirits, wine, and beer.

Foreign Tax Credit. Simplifies the categories (from nine to two) used in calculating the tax credit for foreign taxes paid by U.S. taxpayers.

Individual AMT Relief. Extends the provision allowing an individual to offset his entire regular tax liability and AMT liability by the personal nonrefundable credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the nonrefundable portion of the child tax credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the IRA credit, and the D.C. homebuyer's credit) for taxable years beginning in 2004 and 2005.

Research Credit. Extends the present-law research credit (set to expire on June 30, 2004) to qualified amounts paid or incurred for research over and above a base amount before January 1, 2006.

Electricity Production Credit. Extends to January 1, 2006, an income tax credit for the production of electricity from either qualified wind energy or qualified biomass.

Work Opportunity Tax Credit. Extends the work opportunity tax credit for two years (through December 31, 2005). The work opportunity tax credit is available on an elective basis (up to $2400 per employee) for employers hiring individuals from one or more of the following groups: (1) families eligible to receive benefits under the Temporary Assistance for Needy Families (TANF) Program; (2) high-risk youth; (3) qualified ex-felons; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; (7)

families receiving food stamps; and (8) persons receiving certain Supplemental Security Income benefits.

Welfare-to-Work Tax Credit. Extends the welfare-to-work tax credit for two years (through December 31, 2005). The welfare-to-work tax credit (up to $8500 per qualified employee) is available on an elective basis for employers for the first $20,000 of eligible wages paid to qualified long-term family assistance recipients during the first two years of employment. The credit is 35% of the first $10,000 of eligible wages in the first year of employment and 50% of the first $10,000 of eligible wages in the second year of employment.

Elementary and Secondary School Teachers Deduction. Extends for two years (2004 and 2005) the availability of the above-the-line deduction (up to $250) for expenses paid or incurred by an eligible educator for books, most supplies, computer equipment (including related software and services) and other equipment and supplementary materials used by the eligible educator in the classroom.

Computer Contributions. Extends the enhanced deduction for qualified computer contributions to contributions made during 2004.

Archer Medical Savings Accounts. Extends Archer MSAs through December 31, 2004. Individual contributions to an Archer MSA are deductible (within limits) in determining adjusted gross income. Further, employer contributions are excludable from gross income and wages for employment tax purposes (also within certain limits).

District of Columbia. Extends tax-incentives for investment (including first-time home-buying) in DC for two years (through December 31, 2005).

Electric and Clean-Fuel Vehicles. Suspends the phase-down of the maximum tax credit for electric vehicles and the deduction for clean-fuel vehicles in 2004 and 2005. That is, a taxpayer who purchases a qualifying vehicle could claim 100% of the otherwise allowable credit or deduction for vehicles purchased in 2004 and 2005.

State and Local Sales Tax Deduction. Provides that, at the election of the taxpayer, an itemized federal tax deduction may be taken (for tax-years 2004 and 2005) for state and local general sales taxes in lieu of the itemized deduction provided under present law for state and local income taxes. The amount of the deduction would be determined by the Secretary of the Treasury. Under current law, an itemized federal tax deduction is permitted for state individual income taxes, real property taxes, and personal property taxes.

Corporate Inversions. Applies special (i.e. punitive) tax rules to corporations that invert (or otherwise undertake certain defined inversion transactions). Imposes an excise tax upon specified holders of stock options and other stock-based compensation from companies that invert.

Individual Expatriation. Establishes new tax rules for individual expatriates. Provides: (1) more objective standards for determining whether former citizens or former long-term residents are subject to the AMT; (2) tax-based (instead of immigration-based) rules for determining when an individual is no longer a U.S. citizen or long-term resident for federal tax purposes; (3) the imposition of full U.S. taxation for individuals who are subject to the AMT and who return to the U.S. for extended periods; (4) imposition of the federal gift tax on gifts of stock of certain closely-held foreign corporations that hold U.S. property; and (5) an annual return-filing requirement for individuals who are subject to the AMT for each of the ten years following citizenship relinquishment or residency termination.

Failure to Disclose. Creates a new penalty for any person who fails to include with any return or statement any required information with respect to a reportable transaction (to be defined by the Secretary of the Treasury). The new penalty would apply without regard to whether the transaction ultimately results in an understatement of tax and in addition to any accuracy-related penalty that could already be imposed. Disallows any deduction for interest paid or accrued on any portion of an underpayment of tax that is attributable to an undisclosed reportable transaction, if a significant purpose of such transaction is the evasion of federal income tax.

Illegal Tax Shelters. Increases the penalties for organizing or knowingly participating in illegal tax shelters.

Overpayment Interest. Excludes from gross income overpayment interest that is paid to individual taxpayers on their federal tax overpayments.

IRS Installment Agreements. Authorizes the IRS to enter into installment agreements with taxpayers that provide for only partial payment of the taxpayer's liability (based on a change in the taxpayer's financial situation) over the life of the agreement.

Fuel Excise Tax. Provides for certain increased exemptions from the fuel excise tax.

IRS Inspections of Fuel. Expands the scope of IRS inspections of places where taxable fuel is produced or stored to include any books, records, or shipping papers pertaining to taxable fuel at the place of inspection. Under current law, such an IRS inspection is authorized to: (1) examine the equipment used to determine the amount or composition of the taxable fuel and the equipment used to store the fuel, and (2) take and remove samples of taxable fuel. Places of inspection include terminals, fuel storage facilities, and retail fuel facilities.

Dedicating Penalties to the Highway Trust Fund. Dedicates various collected penalties (regarding, for example, dyed fuel and displaying tax registration on vessels) to the Highway Trust Fund. Current law does not dedicate any Treasury-collected penalties to the Highway Trust Fund.

Private Debt Collectors. Authorizes the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities of any type and to arrange payment of those taxes by the taxpayers.

Charitable Contributions of Vehicles. Permits a charitable deduction for contributions of vehicles for which the taxpayer claims a deduction of more than $250 only if the taxpayer obtains a qualified appraisal of the vehicle.

Vaccines. Adds any hepatitis A vaccine and any three-component flu vaccine to the list of taxable vaccines.

User Fee Extensions. Extends through September 30, 2014 the passenger and conveyance processing fees and the merchandise processing fees at U.S. customs stations. Also extends through September 30, 2014 the authorization for the user fees for IRS-provided written responses to questions from individuals, corporations, and organizations about their tax status or the tax effects of particular transactions.

Tobacco Buyout. Repeals the federal tobacco support program, including the marketing quotas and the non-recourse marketing loans, effective on the date of enactment of this legislation. Does not affect assessments and liabilities before the date of enactment.
The buyout: provides quota holders $7.00 per pound on their 2002 quota allotment paid in equal installments over five years and provides producers transition payments of $3.00 per pound based on their 2002 quota levels also paid in equal installments over five years. Caps payments to quota holders and growers at **$9.6 billion** over fiscal years 2005 through 2009. Authorizes assessments on tobacco in 2005 and afterwards necessary to cover federal loan losses arising from the termination of the tobacco support program.

Background: The current tobacco program has two main components: a supply management component and a price-support component. In 1982, Congress passed the No-Net-Cost Tobacco Program Act, which assured the price-support component of the tobacco program would run at no net cost to the federal government.

The supply management component limits the quantity of tobacco marketed by farmers via marketing quotas. The Secretary of Agriculture raises or lowers the national marketing quota on an annual basis and establishes the national marketing quota for each type of tobacco based upon domestic and export demand (but in such a way as to keep the price of tobacco high). Tobacco growers who do not have sufficient quota may purchase or rent one.

Federal support prices are established and guaranteed through the mechanism of non-recourse loans available on each farmer's marketed crop. This system guarantees minimum prices for the different types of tobacco.

The Joint Committee on Taxation reports that over 80% of tobacco growers market their tobacco through contracts with tobacco companies and thus do not participate in the federal loan program. However, these growers must still pay the no-net-cost assessment when the Secretary of Agriculture levies it.

Additional Background:

In 2000, the European Union succeeded in having the FSC tax regime declared a prohibited export subsidy by the WTO. In response to this WTO ruling, the United States repealed the FSC rules and enacted a new regime under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000. The EU immediately challenged the ETI regime in the WTO, and in January of 2002 a WTO Appellate Body held that the ETI regime also constituted a prohibited export subsidy under the relevant trade agreements. The EU has since levied WTO-approved sanctions on various U.S. goods.

Under the ETI regime, an exclusion from gross income applies with respect to "extraterritorial income," which is a taxpayer's gross income attributable to "foreign trading gross receipts."

Committee Action: On June 14, 2004, the Ways & Means Committee marked up and ordered the amended bill reported to the full House by a vote of 27-9.

Possible Conservative Concerns: Many conservatives have expressed concerns about the high cost of the "tobacco buyout" provisions of this legislation.

Cost to Taxpayers: The Joint Committee on Taxation reports that the amended bill would reduce revenues (static estimate) by $1.186 billion in FY2004 and by $24.446 billion over the FY2004-FY2008 period. Additionally, the bill would increase mandatory spending by $0 in FY2004 and by $8.291 billion over the FY2004-FY2008 period.

Does the Bill Create New Federal Programs or Rules?: Various new tax rules.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: No.

Constitutional Authority: Committee Report 108-548, which cites constitutional authority, was not available at press-time.

Outside Organizations: The U.S. Chamber of Commerce and Americans for Tax Reform strongly support this legislation and are likely to include a vote on this bill in their annual ratings of Members of Congress.

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718