110TH CONGRESS 1st Session } HOUSE OF REPRESENTATIVES { REPORT 110–

TEMPORARY TAX RELIEF ACT OF 2007

NOVEMBER , 2007.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. RANGEL, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 3996]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 3996) to amend the Internal Revenue Code of 1986 to extend certain expiring provisions, and for other purposes, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Temporary Tax Relief Act of 2007".

(b) REFERENCE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

TITLE I—AMT RELIEF

SEC. 101. EXTENSION OF ALTERNATIVE MINIMUM TAX RELIEF FOR NONREFUNDABLE PERSONAL CREDITS.

(a) IN GENERAL.—Paragraph (2) of section 26(a) (relating to special rule for taxable years 2000 through 2006) is amended—

(1) by striking "or 2006" and inserting "2006, or 2007", and

(2) by striking "2006" in the heading thereof and inserting "2007".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2006.

SEC. 102. EXTENSION OF INCREASED ALTERNATIVE MINIMUM TAX EXEMPTION AMOUNT.

(a) IN GENERAL.—Paragraph (1) of section 55(d) (relating to exemption amount) is amended—

(1) by striking "($62,550 in the case of taxable years beginning in 2006)" in subparagraph (A) and inserting "($66,250 in the case of taxable years beginning in 2007)", and

(2) by striking "($42,500 in the case of taxable years beginning in 2006)" in subparagraph (B) and inserting "($44,350 in the case of taxable years beginning in 2007)".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2006.

SEC. 103. INCREASE OF AMT REFUNDABLE CREDIT AMOUNT FOR INDIVIDUALS WITH LONG-TERM UNUSED CREDITS FOR PRIOR YEAR MINIMUM TAX LIABILITY, ETC.

(a) IN GENERAL.—Paragraph (2) of section 53(e) of the Internal Revenue Code of 1986 is amended to read as follows:

"(2) AMT REFUNDABLE CREDIT AMOUNT.—For purposes of paragraph (1), the term 'AMT refundable credit amount' means, with respect to any taxable year, the amount (not in excess of the long-term unused minimum tax credit for such taxable year) equal to the greater of—

"(A) 50 percent of the long-term unused minimum tax credit for such taxable year, or

"(B) the amount (if any) of the AMT refundable credit amount determined under this paragraph for the taxpayer's preceding taxable year.".

(b) TREATMENT OF CERTAIN UNDERPAYMENTS, INTEREST, AND PENALTIES ATTRIBUTABLE TO THE TREATMENT OF INCENTIVE STOCK OPTIONS.—Section 53 of such Code is amended by adding at the end the following new subsection:

"(f) TREATMENT OF CERTAIN UNDERPAYMENTS, INTEREST, AND PENALTIES ATTRIBUTABLE TO THE TREATMENT OF INCENTIVE STOCK OPTIONS.—

"(1) ABATEMENT.—Any underpayment of tax outstanding on the date of the enactment of this subsection which is attributable to the application of section 56(b)(3) for any taxable year ending before January 1, 2007 (and any interest or penalty with respect to such underpayment which is outstanding on such date of enactment), is hereby abated. No credit shall be allowed under this section with respect to any amount abated under this paragraph.

"(2) INCREASE IN CREDIT FOR CERTAIN INTEREST AND PENALTIES ALREADY PAID.—Any interest or penalty paid before the date of the enactment of this subsection which would (but for such payment) have been abated under paragraph (1) shall be treated for purposes of this section as an amount of adjusted net minimum tax imposed for the taxable year of the underpayment to which such interest or penalty relates.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by this section shall apply to taxable years beginning after December 31, 2006.

(2) ABATEMENT.—Section 53(f)(1) of the Internal Revenue Code of 1986, as added by subsection (b), shall take effect on the date of the enactment of this Act.

TITLE II—ADDITIONAL INDIVIDUAL TAX RELIEF

SEC. 201. REFUNDABLE CHILD CREDIT.

(a) MODIFICATION OF THRESHOLD AMOUNT.—Clause (i) of section 24(d)(1)(B) is amended by inserting "($8,500 in the case of taxable years beginning in 2008)" after "$10,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2007.

SEC. 202. ADDITIONAL STANDARD DEDUCTION FOR REAL PROPERTY TAXES FOR NON-ITEMIZERS.

(a) IN GENERAL.—Section 63(c)(1) (defining standard deduction) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) in the case of any taxable year beginning in 2008, the real property tax deduction.".

(b) DEFINITION.—Section 63(c) is amended by adding at the end the following new paragraph:

"(8) REAL PROPERTY TAX DEDUCTION.—For purposes of paragraph (1), the real property tax deduction is so much of the amount of State and local real property taxes (within the meaning of section 164) paid or accrued by the taxpayer during the taxable year which do not exceed $350 ($700 in the case of a joint return).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2007.

TITLE III—ONE-YEAR EXTENDERS

Subtitle A—Extenders Primarily Affecting Individuals

SEC. 301. DEDUCTION FOR STATE AND LOCAL SALES TAXES.

(a) IN GENERAL.—Subparagraph (I) of section 164(b)(5) is amended by striking "January 1, 2008" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2007.

SEC. 302. DEDUCTION OF QUALIFIED TUITION AND RELATED EXPENSES.

(a) IN GENERAL.—Subsection (e) of section 222 (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2007.

SEC. 303. TREATMENT OF CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.

(a) INTEREST-RELATED DIVIDENDS.—Subparagraph (C) of section 871(k)(1) (defining interest-related dividend) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) SHORT-TERM CAPITAL GAIN DIVIDENDS.—Subparagraph (C) of section 871(k)(2) (defining short-term capital gain dividend) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dividends with respect to taxable years of regulated investment companies beginning after December 31, 2007.

SEC. 304. PARITY IN THE APPLICATION OF CERTAIN LIMITS TO MENTAL HEALTH BENEFITS.

(a) IN GENERAL.—Paragraph (3) of section 9812(f) (relating to application of section) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to benefits for services furnished after December 31, 2007.

SEC. 305. QUALIFIED CONSERVATION CONTRIBUTIONS.

(a) IN GENERAL.—Clause (vi) of section 170(b)(1)(E) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made in taxable years beginning after December 31, 2007.

SEC. 306. TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR CHARITABLE PURPOSES.

(a) IN GENERAL.—Subparagraph (F) of section 408(d)(8) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to distributions made in taxable years beginning after December 31, 2007.

SEC. 307. DEDUCTION FOR CERTAIN EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS.

(a) IN GENERAL.—Subparagraph (D) of section 62(a)(2) (relating to certain expenses of elementary and secondary school teachers) is amended by striking "or 2007" and inserting "2007, or 2008".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2007.

SEC. 308. ELECTION TO INCLUDE COMBAT PAY AS EARNED INCOME FOR PURPOSES OF EARNED INCOME TAX CREDIT.

(a) IN GENERAL.—Subclause (II) of section 32(c)(2)(B)(vi) (defining earned income) is amended by striking "January 1, 2008" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years ending after December 31, 2007.

SEC. 309. MODIFICATION OF MORTGAGE REVENUE BONDS FOR VETERANS.

(a) QUALIFIED MORTGAGE BONDS USED TO FINANCE RESIDENCES FOR VETERANS WITHOUT REGARD TO FIRST-TIME HOMEBUYER REQUIREMENT.—Subparagraph (D) of section 143(d)(2) (relating to exceptions) is amended by striking "January 1, 2008" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to bonds issued after December 31, 2007.

SEC. 310. DISTRIBUTIONS FROM RETIREMENT PLANS TO INDIVIDUALS CALLED TO ACTIVE DUTY.

(a) IN GENERAL.—Clause (iv) of section 72(t)(2)(G) is amended by striking "December 31, 2007" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to individuals ordered or called to active duty on or after December 31, 2007.

SEC. 311. STOCK IN RIC FOR PURPOSES OF DETERMINING ESTATES OF NONRESIDENTS NOT CITIZENS.

(a) IN GENERAL.—Paragraph (3) of section 2105(d) (relating to stock in a RIC) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to decedents dying after December 31, 2007.

SEC. 312. QUALIFIED INVESTMENT ENTITIES.

(a) IN GENERAL.—Clause (ii) of section 897(h)(4)(A) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on January 1, 2008.

SEC. 313. STATE LEGISLATORS' TRAVEL EXPENSES AWAY FROM HOME.

(a) IN GENERAL.—Paragraph (2) of section 162(h) (relating to legislative days) is amended by adding at the end the following flush sentence: "In the case of taxable years beginning in 2008, a legislature shall be treated for purposes of this paragraph as in session on any day in which it is formally called into session without regard to whether legislation was considered on such day.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2007.

Subtitle B—Extenders Primarily Affecting Businesses

SEC. 321. RESEARCH CREDIT.

(a) IN GENERAL.—Subparagraph (B) of section 41(h)(1) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) CONFORMING AMENDMENT.—Subparagraph (D) of section 45C(b)(1) (relating to qualified clinical testing expenses) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 2007.

SEC. 322. INDIAN EMPLOYMENT CREDIT.

(a) IN GENERAL.—Subsection (f) of section 45A (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2007.

SEC. 323. NEW MARKETS TAX CREDIT.

Subparagraph (D) of section 45D(f)(1) (relating to national limitation on amount of investments designated) is amended by striking "and 2008" and inserting "2008, and 2009".

SEC. 324. RAILROAD TRACK MAINTENANCE.

(a) IN GENERAL.—Subsection (f) of section 45G (relating to application of section) is amended by striking "January 1, 2008" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenditures paid or incurred during taxable years beginning after December 31, 2007.

SEC. 325. FIFTEEN-YEAR STRAIGHT-LINE COST RECOVERY FOR QUALIFIED LEASEHOLD IMPROVEMENTS AND QUALIFIED RESTAURANT PROPERTY.

(a) IN GENERAL.—Clauses (iv) and (v) of section 168(e)(3)(E) (relating to 15-year property) are each amended by striking "January 1, 2008" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2007.

SEC. 326. SEVEN-YEAR COST RECOVERY PERIOD FOR MOTORSPORTS RACING TRACK FACILITY.

(a) IN GENERAL.—Subparagraph (D) of section 168(i)(15) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 2007.

SEC. 327. ACCELERATED DEPRECIATION FOR BUSINESS PROPERTY ON INDIAN RESERVATION.

(a) IN GENERAL.—Paragraph (8) of section 168(j) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 2007.

SEC. 328. EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.

(a) IN GENERAL.—Subsection (h) of section 198 (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenditures paid or incurred after December 31, 2007.

SEC. 329. DEDUCTION ALLOWABLE WITH RESPECT TO INCOME ATTRIBUTABLE TO DOMESTIC PRODUCTION ACTIVITIES IN PUERTO RICO.

(a) IN GENERAL.—Subparagraph (C) of section 199(d)(8) (relating to termination) is amended—

(1) by striking "first 2 taxable years" and inserting "first 3 taxable years", and

(2) by striking "January 1, 2008" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2007.

SEC. 330. MODIFICATION OF TAX TREATMENT OF CERTAIN PAYMENTS TO CONTROLLING EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Clause (iv) of section 512(b)(13)(E) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments received or accrued after December 31, 2007.

SEC. 331. EXTENSION AND MODIFICATION OF CREDIT TO HOLDERS OF QUALIFIED ZONE ACADEMY BONDS.

(a) IN GENERAL.—Subsection (e) of section 1397E (relating to limitation on amount of bonds designated) is amended by striking "1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, and 2007" and inserting "each of calendar years 1998 through 2008".

(b) MODIFICATION OF ARBITRAGE RULES.—

(1) IN GENERAL.—Subsection (g) of section 1397E (relating to special rules relating to arbitrage) is amended to read as follows:

"(g) SPECIAL RULES RELATING TO ARBITRAGE.—

"(1) IN GENERAL.—An issue shall be treated as meeting the requirements of this subsection if the issuer satisfies the requirements of section 148 with respect to the proceeds of the issue.

"(2) SPECIAL RULE FOR INVESTMENTS DURING EXPENDITURE PERIOD.—An issue shall not be treated as failing to meet the requirements of paragraph (1) by reason of any investment of available project proceeds during the 5-year period described in subsection (f)(1)(A) (including any extension of such period under subsection (f)(2)).

"(3) SPECIAL RULE FOR RESERVE FUNDS.—An issue shall not be treated as failing to meet the requirements of paragraph (1) by reason of any fund which is expected to be used to repay such issue if—

"(A) such fund is funded at a rate not more rapid than equal annual installments,

"(B) such fund is funded in a manner that such fund will not exceed the amount necessary to repay the issue if invested at the maximum rate permitted under subparagraph (C), and

"(C) the yield on such fund is not greater than the discount rate determined under subsection (d)(3) with respect to the issue.".

(2) APPLICATION OF AVAILABLE PROJECT PROCEEDS TO OTHER REQUIREMENTS.—Subsections (d)(1)(A), (d)(2)(A), (f)(1)(A), (f)(1)(B), (f)(1)(C), and (f)(3) of section 1397E are each amended by striking "proceeds" and inserting "available project proceeds"

(3) AVAILABLE PROJECT PROCEEDS DEFINED.—Subsection (i) of section 1397E (relating to definitions) is amended by adding at the end the following new paragraph:

"(4) AVAILABLE PROJECT PROCEEDS.—The term 'available project proceeds' means—

"(A) the excess of—

"(i) the proceeds from the sale of an issue, over

"(ii) the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and

"(B) the proceeds from any investment of the excess described in subparagraph (A).".

(c) EFFECTIVE DATE.—

(1) EXTENSION.—The amendment made by subsection (a) shall apply to obligations issued after December 31, 2007.

(2) MODIFICATION OF ARBITRAGE RULES.—The amendments made by subsection (b) shall apply to obligations issued after the date of the enactment of this Act.

SEC. 332. TAX INCENTIVES FOR INVESTMENT IN THE DISTRICT OF COLUMBIA.

(a) DESIGNATION OF ZONE.—

(1) IN GENERAL.—Subsection (f) of section 1400 is amended by striking "2007" both places it appears and inserting "2008".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to periods beginning after December 31, 2007.

(b) TAX-EXEMPT ECONOMIC DEVELOPMENT BONDS.—

(1) IN GENERAL.—Subsection (b) of section 1400A is amended by striking "2007" and inserting "2008".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to bonds issued after December 31, 2007.

(c) ZERO PERCENT CAPITAL GAINS RATE.—

(1) IN GENERAL.—Subsection (b) of section 1400B is amended by striking "2008" each place it appears and inserting "2009".

(2) CONFORMING AMENDMENTS.—

(A) Section 1400B(e)(2) is amended—

(i) by striking "2012" and inserting "2013", and

(ii) by striking "2012" in the heading thereof and inserting "2013".

(B) Section 1400B(g)(2) is amended by striking "2012" and inserting "2013".

(C) Section 1400F(d) is amended by striking "2012" and inserting "2013".

(3) EFFECTIVE DATES.—

(A) EXTENSION.—The amendments made by paragraph (1) shall apply to acquisitions after December 31, 2007.

(B) CONFORMING AMENDMENTS.—The amendments made by paragraph (2) shall take effect on the date of the enactment of this Act.

(d) FIRST-TIME HOMEBUYER CREDIT.—

(1) IN GENERAL.—Subsection (i) of section 1400C is amended by striking "2008" and inserting "2009".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to property purchased after December 31, 2007.

SEC. 333. EXTENSION OF ECONOMIC DEVELOPMENT CREDIT FOR AMERICAN SAMOA.

(a) IN GENERAL.—Subsection (d) of section 119 of division A of the Tax Relief and Health Care Act of 2006 is amended—

(1) by striking "first two taxable years" and inserting "first 3 taxable years", and

(2) by striking "January 1, 2008" and inserting "January 1, 2009".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2007.

SEC. 334. ENHANCED CHARITABLE DEDUCTION FOR CONTRIBUTIONS OF FOOD INVENTORY.

(a) IN GENERAL.—Clause (iv) of section 170(e)(3)(C) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made after December 31, 2007.

SEC. 335. ENHANCED CHARITABLE DEDUCTION FOR CONTRIBUTIONS OF BOOK INVENTORY TO PUBLIC SCHOOLS.

(a) IN GENERAL.—Clause (iv) of section 170(e)(3)(D) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made after December 31, 2007.

SEC. 336. ENHANCED DEDUCTION FOR QUALIFIED COMPUTER CONTRIBUTIONS.

(a) IN GENERAL.—Subparagraph (G) of section 170(e)(6) (relating to termination) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions made during taxable years beginning after December 31, 2007.

SEC. 337. BASIS ADJUSTMENT TO STOCK OF S CORPORATIONS MAKING CHARITABLE CONTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—The last sentence of section 1367(a)(2) (relating to decreases in basis) is amended by striking "December 31, 2007" and inserting "December 31, 2008".

(b) TECHNICAL AMENDMENT RELATED TO SECTION 1203 OF THE PENSION PROTECTION ACT OF 2006.—Subsection (d) of section 1366 is amended by adding at the end the following new paragraph:

"(4) APPLICATION OF LIMITATION ON CHARITABLE CONTRIBUTIONS.—In the case of any charitable contribution of property to which the second sentence of section 1367(a)(2) applies, paragraph (1) shall not apply to the extent of the excess (if any) of—

"(A) the shareholder's pro rata share of such contribution, over

"(B) the shareholder's pro rata share of the adjusted basis of such property.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to contributions made in taxable years beginning after December 31, 2007.

(2) TECHNICAL AMENDMENT.—The amendment made by subsection (b) shall take effect as if included in the provision of the Pension Protection Act of 2006 to which it relates.

SEC. 338. EXTENSION OF WORK OPPORTUNITY TAX CREDIT FOR HURRICANE KATRINA EMPLOYEES.

(a) IN GENERAL.—Paragraph (1) of section 201(b) of the Katrina Emergency Tax Relief Act of 2005 is amended by striking “2-year” and inserting “3-year”.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to individuals hired after August 27, 2007.

Subtitle C—Other Extenders

SEC. 341. DISCLOSURE FOR COMBINED EMPLOYMENT TAX REPORTING.

(a) IN GENERAL.—Subparagraph (B) of section 6103(d)(5) (relating to termination) is amended by striking “December 31, 2007” and inserting “December 31, 2008”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to disclosures after December 31, 2007.

SEC. 342. DISCLOSURE OF RETURN INFORMATION TO APPRISE APPROPRIATE OFFICIALS OF TERRORIST ACTIVITIES.

(a) IN GENERAL.—Clause (iv) of section 6103(i)(3)(C) (relating to termination) is amended by striking “December 31, 2007” and inserting “December 31, 2008”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to disclosures after December 31, 2007.

SEC. 343. DISCLOSURE UPON REQUEST OF INFORMATION RELATING TO TERRORIST ACTIVITIES.

(a) IN GENERAL.—Subparagraph (E) of section 6103(i)(7) (relating to termination) is amended by striking “December 31, 2007” and inserting “December 31, 2008”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to disclosures after December 31, 2007.

SEC. 344. DISCLOSURE OF RETURN INFORMATION TO CARRY OUT INCOME CONTINGENT REPAYMENT OF STUDENT LOANS.

(a) IN GENERAL.—Subparagraph (D) of section 6103(l)(13) (relating to termination) is amended by striking “December 31, 2007” and inserting “December 31, 2008”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to requests made after December 31, 2007.

SEC. 345. AUTHORITY FOR UNDERCOVER OPERATIONS.

(a) IN GENERAL.—Paragraph (6) of section 7608(c) (relating to application of section) is amended by striking “January 1, 2008” each place it appears and inserting “January 1, 2009”.

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on January 1, 2008.

SEC. 346. INCREASE IN LIMIT ON COVER OVER OF RUM EXCISE TAX TO PUERTO RICO AND THE VIRGIN ISLANDS.

(a) IN GENERAL.—Paragraph (1) of section 7652(f) is amended by striking “January 1, 2008” and inserting “January 1, 2009”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to distilled spirits brought into the United States after December 31, 2007.

SEC. 347. DISCLOSURE OF RETURN INFORMATION FOR CERTAIN VETERANS PROGRAMS.

(a) IN GENERAL.—The last sentence of paragraph (7) of section 6103(l) is amended by striking “September 30, 2008” and inserting “December 31, 2008”.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to requests made after September 30, 2008.

TITLE IV—MORTGAGE FORGIVENESS DEBT RELIEF

SEC. 401. DISCHARGES OF INDEBTEDNESS ON PRINCIPAL RESIDENCE EXCLUDED FROM GROSS INCOME.

(a) IN GENERAL.—Paragraph (1) of section 108(a) is amended by striking "or" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", or", and by inserting after subparagraph (D) the following new subparagraph:

"(E) the indebtedness discharged is qualified principal residence indebtedness.".

(b) SPECIAL RULES RELATING TO QUALIFIED PRINCIPAL RESIDENCE INDEBTEDNESS.—Section 108 is amended by adding at the end the following new subsection:

"(h) SPECIAL RULES RELATING TO QUALIFIED PRINCIPAL RESIDENCE INDEBTEDNESS.—

"(1) BASIS REDUCTION.—The amount excluded from gross income by reason of subsection (a)(1)(E) shall be applied to reduce (but not below zero) the basis of the principal residence of the taxpayer.

"(2) QUALIFIED PRINCIPAL RESIDENCE INDEBTEDNESS.—For purposes of this section, the term 'qualified principal residence indebtedness' means acquisition indebtedness (within the meaning of section 163(h)(3)(B), applied by substituting '$2,000,000 ($1,000,000' for '$1,000,000 ($500,000' in clause (ii) thereof) with respect to the principal residence of the taxpayer.

"(3) EXCEPTION FOR CERTAIN DISCHARGES NOT RELATED TO TAXPAYER'S FINANCIAL CONDITION.—Subsection (a)(1)(E) shall not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

"(4) ORDERING RULE.—If any loan is discharged, in whole or in part, and only a portion of such loan is qualified principal residence indebtedness, subsection (a)(1)(E) shall apply only to so much of the amount discharged as exceeds the amount of the loan (as determined immediately before such discharge) which is not qualified principal residence indebtedness.

"(5) PRINCIPAL RESIDENCE.—For purposes of this subsection, the term 'principal residence' has the same meaning as when used in section 121.".

(c) COORDINATION.—

(1) Subparagraph (A) of section 108(a)(2) is amended by striking "and (D)" and inserting "(D), and (E)".

(2) Paragraph (2) of section 108(a) is amended by adding at the end the following new subparagraph:

"(C) PRINCIPAL RESIDENCE EXCLUSION TAKES PRECEDENCE OVER INSOLVENCY EXCLUSION UNLESS ELECTED OTHERWISE.—Paragraph (1)(B) shall not apply to a discharge to which paragraph (1)(E) applies unless the taxpayer elects to apply paragraph (1)(B) in lieu of paragraph (1)(E).".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to discharges of indebtedness on or after January 1, 2007.

SEC. 402. LONG-TERM EXTENSION OF DEDUCTION FOR MORTGAGE INSURANCE PREMIUMS.

(a) IN GENERAL.—Subparagraph (E) of section 163(h)(3) (relating to mortgage insurance premiums treated as interest) is amended by striking clauses (iii) and (iv) and inserting the following new clause:

"(iii) APPLICATION.—Clause (i) shall not apply with respect to any mortgage insurance contract issued before January 1, 2007, or after December 31, 2014.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to contracts issued after December 31, 2006.

SEC. 403. ALTERNATIVE TESTS FOR QUALIFYING AS COOPERATIVE HOUSING CORPORATION.

(a) IN GENERAL.—Subparagraph (D) of section 216(b)(1) (defining cooperative housing corporation) is amended to read as follows:

"(D) meeting 1 or more of the following requirements for the taxable year in which the taxes and interest described in subsection (a) are paid or incurred:

"(i) 80 percent or more of the corporation's gross income for such taxable year is derived from tenant-stockholders.

"(ii) At all times during such taxable year, 80 percent or more of the total square footage of the corporation's property is used or available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use.

"(iii) 90 percent or more of the expenditures of the corporation paid or incurred during such taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of the tenant-stockholders.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 404. GAIN FROM SALE OF PRINCIPAL RESIDENCE ALLOCATED TO NONQUALIFIED USE NOT EXCLUDED FROM INCOME.

(a) IN GENERAL.—Subsection (b) of section 121 (relating to limitations) is amended by adding at the end the following new paragraph:

"(4) EXCLUSION OF GAIN ALLOCATED TO NONQUALIFIED USE.—

"(A) IN GENERAL.—Subsection (a) shall not apply to so much of the gain from the sale or exchange of property as is allocated to periods of nonqualified use.

"(B) GAIN ALLOCATED TO PERIODS OF NONQUALIFIED USE.—For purposes of subparagraph (A), gain shall be allocated to periods of nonqualified use based on the ratio which—

"(i) the aggregate periods of nonqualified use during the period such property was owned by the taxpayer, bears to

"(ii) the period such property was owned by the taxpayer.

"(C) PERIOD OF NONQUALIFIED USE.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'period of nonqualified use' means any period (other than the portion of any period preceding January 1, 2008) during which the property is not used as the principal residence of the taxpayer or the taxpayer's spouse or former spouse.

"(ii) EXCEPTIONS.—The term 'period of nonqualified use' does not include—

"(I) any portion of the 5-year period described in subsection (a) which is after the last date that such property is used as the principal residence of the taxpayer or the taxpayer's spouse,

"(II) any period (not to exceed an aggregate period of 10 years) during which the taxpayer or the taxpayer's spouse is serving on qualified official extended duty (as defined in subsection (d)(9)(C)) described in clause (i), (ii), or (iii) of subsection (d)(9)(A), and

"(III) any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the Secretary.

"(D) COORDINATION WITH RECOGNITION OF GAIN ATTRIBUTABLE TO DEPRECIATION.—For purposes of this paragraph—

"(i) subparagraph (A) shall be applied after the application of subsection (d)(6), and

"(ii) subparagraph (B) shall be applied without regard to any gain to which subsection (d)(6) applies.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to sales and exchanges after December 31, 2007.

TITLE V—ADMINISTRATIVE PROVISIONS

SEC. 501. REPEAL OF AUTHORITY TO ENTER INTO PRIVATE DEBT COLLECTION CONTRACTS.

(a) IN GENERAL.—Subchapter A of chapter 64 is amended by striking section 6306.

(b) CONFORMING AMENDMENTS.—

(1) Subchapter B of chapter 76 is amended by striking section 7433A.

(2) Section 7811 is amended by striking subsection (g).

(3) Section 1203 of the Internal Revenue Service Restructuring Act of 1998 is amended by striking subsection (e).

(4) The table of sections for subchapter A of chapter 64 is amended by striking the item relating to section 6306.

(5) The table of sections for subchapter B of chapter 76 is amended by striking the item relating to section 7433A.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall take effect on the date of the enactment of this Act.

(2) EXCEPTION FOR EXISTING CONTRACTS, ETC.—The amendments made by this section shall not apply to any contract which was entered into before July 18, 2007, and is not renewed or extended on or after such date.

(3) UNAUTHORIZED CONTRACTS AND EXTENSIONS TREATED AS VOID.—Any qualified tax collection contract (as defined in section 6306 of the Internal Revenue Code of 1986, as in effect before its repeal) which is entered into on or after July 18, 2007, and any extension or renewal on or after such date of any qualified tax collection contract (as so defined) shall be void.

SEC. 502. DELAY OF APPLICATION OF WITHHOLDING REQUIREMENT ON CERTAIN GOVERNMENTAL PAYMENTS FOR GOODS AND SERVICES.

(a) IN GENERAL.—Subsection (b) of section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 is amended by striking "December 31, 2010" and inserting "December 31, 2011".

(b) REPORT TO CONGRESS.—Not later than 6 months after the date of the enactment of this Act, the Secretary of the Treasury shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report with respect to the withholding requirements of section 3402(t) of the Internal Revenue Code of 1986, including a detailed analysis of—

(1) the problems, if any, which are anticipated in administering and complying with such requirements,

(2) the burdens, if any, that such requirements will place on governments and businesses (taking into account such mechanisms as may be necessary to administer such requirements), and

(3) the application of such requirements to small expenditures for services and goods by governments.

SEC. 503. CLARIFICATION OF ENTITLEMENT OF VIRGIN ISLANDS RESIDENTS TO PROTECTIONS OF LIMITATIONS ON ASSESSMENT AND COLLECTION OF TAX.

(a) IN GENERAL.—Subsection (c) of section 932 (relating to treatment of Virgin Islands residents) is amended by adding at the end the following new paragraph:

"(5) TREATMENT OF INCOME TAX RETURN FILED WITH VIRGIN ISLANDS.—An income tax return filed with the Virgin Islands by an individual claiming to be described in paragraph (1) for the taxable year shall be treated for purposes of subtitle F in the same manner as if such return were an income tax return filed with the United States for such taxable year. The preceding sentence shall not apply where such return is false or fraudulent with the intent to evade tax or otherwise is a willful attempt in any manner to defeat or evade tax.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after 1986.

SEC. 504. REVISION OF TAX RULES ON EXPATRIATION.

(a) IN GENERAL.—Subpart A of part II of subchapter N of chapter 1 is amended by inserting after section 877 the following new section:

"SEC. 877A. TAX RESPONSIBILITIES OF EXPATRIATION.

"(a) GENERAL RULES.—For purposes of this subtitle—

"(1) MARK TO MARKET.—All property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value.

"(2) RECOGNITION OF GAIN OR LOSS.—In the case of any sale under paragraph (1)—

"(A) notwithstanding any other provision of this title, any gain arising from such sale shall be taken into account for the taxable year of the sale, and

"(B) any loss arising from such sale shall be taken into account for the taxable year of the sale to the extent otherwise provided by this title, except that section 1091 shall not apply to any such loss.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence, determined without regard to paragraph (3).

"(3) EXCLUSION FOR CERTAIN GAIN.—

"(A) IN GENERAL.—The amount which would (but for this paragraph) be includible in the gross income of any individual by reason of paragraph (1) shall be reduced (but not below zero) by $600,000.

"(B) ADJUSTMENT FOR INFLATION.—

"(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2008, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 2007' for 'calendar year 1992' in subparagraph (B) thereof.

"(ii) ROUNDING.—If any amount as adjusted under clause (i) is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.

"(b) ELECTION TO DEFER TAX.—

"(1) IN GENERAL.—If the taxpayer elects the application of this subsection with respect to any property treated as sold by reason of subsection (a), the time for payment of the additional tax attributable to such property shall be extended until the due date of the return for the taxable year in which such property is disposed of (or, in the case of property disposed of in a transaction in which gain is not recognized in whole or in part, until such other date as the Secretary may prescribe).

"(2) DETERMINATION OF TAX WITH RESPECT TO PROPERTY.—For purposes of paragraph (1), the additional tax attributable to any property is an amount which bears the same ratio to the additional tax imposed by this chapter for the taxable year solely by reason of subsection (a) as the gain taken into account under subsection (a) with respect to such property bears to the total gain taken into account under subsection (a) with respect to all property to which subsection (a) applies.

"(3) TERMINATION OF EXTENSION.—The due date for payment of tax may not be extended under this subsection later than the due date for the return of tax imposed by this chapter for the taxable year which includes the date of death of the expatriate (or, if earlier, the time that the security provided with respect to the property fails to meet the requirements of paragraph (4), unless the taxpayer corrects such failure within the time specified by the Secretary).

"(4) SECURITY.—

"(A) IN GENERAL.—No election may be made under paragraph (1) with respect to any property unless adequate security is provided with respect to such property.

"(B) ADEQUATE SECURITY.—For purposes of subparagraph (A), security with respect to any property shall be treated as adequate security if—

"(i) it is a bond which is furnished to, and accepted by, the Secretary, which is conditioned on the payment of tax (and interest thereon), and which meets the requirements of section 6325, or

"(ii) it is another form of security for such payment (including letters of credit) that meets such requirements as the Secretary may prescribe.

"(5) WAIVER OF CERTAIN RIGHTS.—No election may be made under paragraph (1) unless the taxpayer makes an irrevocable waiver of any right under any treaty of the United States which would preclude assessment or collection of any tax imposed by reason of this section.

"(6) ELECTIONS.—An election under paragraph (1) shall only apply to property described in the election and, once made, is irrevocable.

"(7) INTEREST.—For purposes of section 6601, the last date for the payment of tax shall be determined without regard to the election under this subsection.

"(c) EXCEPTION FOR CERTAIN PROPERTY.—Subsection (a) shall not apply to—

"(1) any deferred compensation item (as defined in subsection (d)(4)),

"(2) any specified tax deferred account (as defined in subsection (e)(2)), and

"(3) any interest in a nongrantor trust (as defined in subsection (f)(3)).

"(d) TREATMENT OF DEFERRED COMPENSATION ITEMS.—

"(1) WITHHOLDING ON ELIGIBLE DEFERRED COMPENSATION ITEMS.—

"(A) IN GENERAL.—In the case of any eligible deferred compensation item, the payor shall deduct and withhold from any taxable payment to a covered expatriate with respect to such item a tax equal to 30 percent thereof.

"(B) TAXABLE PAYMENT.—For purposes of subparagraph (A), the term 'taxable payment' means with respect to a covered expatriate any payment to the extent it would be includible in the gross income of the covered expatriate if such expatriate continued to be subject to tax as a citizen or resident of the United States. A deferred compensation item shall be taken into account as a payment under the preceding sentence when such item would be so includible.

"(2) OTHER DEFERRED COMPENSATION ITEMS.—In the case of any deferred compensation item which is not an eligible deferred compensation item—

"(A)(i) with respect to any deferred compensation item to which clause (ii) does not apply, an amount equal to the present value of the covered expatriate's accrued benefit shall be treated as having been received by such individual on the day before the expatriation date as a distribution under the plan, and

"(ii) with respect to any deferred compensation item referred to in paragraph (4)(D), the rights of the covered expatriate to such item shall be treated as becoming transferable and not subject to a substantial risk of forfeiture on the day before the expatriation date,

"(B) no early distribution tax shall apply by reason of such treatment, and

"(C) appropriate adjustments shall be made to subsequent distributions from the plan to reflect such treatment.

"(3) ELIGIBLE DEFERRED COMPENSATION ITEMS.—For purposes of this subsection, the term 'eligible deferred compensation item' means any deferred compensation item with respect to which—

"(A) the payor of such item is—

"(i) a United States person, or

"(ii) a person who is not a United States person but who elects to be treated as a United States person for purposes of paragraph (1) and meets such requirements as the Secretary may provide to ensure that the payor will meet the requirements of paragraph (1), and

"(B) the covered expatriate—

"(i) notifies the payor of his status as a covered expatriate, and

"(ii) makes an irrevocable waiver of any right to claim any reduction under any treaty with the United States in withholding on such item.

"(4) DEFERRED COMPENSATION ITEM.—For purposes of this subsection, the term 'deferred compensation item' means—

"(A) any interest in a plan or arrangement described in section 219(g)(5),

"(B) any interest in a foreign pension plan or similar retirement arrangement or program,

"(C) any item of deferred compensation, and

"(D) any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83 or in accordance with section 83.

"(5) EXCEPTION.—Paragraphs (1) and (2) shall not apply to any deferred compensation item which is attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

"(6) SPECIAL RULES.—

"(A) APPLICATION OF WITHHOLDING RULES.—Rules similar to the rules of subchapter B of chapter 3 shall apply for purposes of this subsection.

"(B) APPLICATION OF TAX.—Any item subject to the withholding tax imposed under paragraph (1) shall be subject to tax under section 871.

"(C) COORDINATION WITH OTHER WITHHOLDING REQUIREMENTS.—Any item subject to withholding under paragraph (1) shall not be subject to withholding under section 1441 or chapter 24.

"(e) TREATMENT OF SPECIFIED TAX DEFERRED ACCOUNTS.—

"(1) ACCOUNT TREATED AS DISTRIBUTED.—In the case of any interest in a specified tax deferred account held by a covered expatriate on the day before the expatriation date—

"(A) the covered expatriate shall be treated as receiving a distribution of his entire interest in such account on the day before the expatriation date,

"(B) no early distribution tax shall apply by reason of such treatment, and

"(C) appropriate adjustments shall be made to subsequent distributions from the account to reflect such treatment.

"(2) SPECIFIED TAX DEFERRED ACCOUNT.—For purposes of paragraph (1), the term 'specified tax deferred account' means an individual retirement plan (as defined in section 7701(a)(37)) other than any arrangement described in subsection (k) or (p) of section 408, a qualified tuition program (as defined in section 529), a Coverdell education savings account (as defined in section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220).

"(f) SPECIAL RULES FOR NONGRANTOR TRUSTS.—

"(1) IN GENERAL.—In the case of a distribution (directly or indirectly) of any property from a nongrantor trust to a covered expatriate—

"(A) the trustee shall deduct and withhold from such distribution an amount equal to 30 percent of the taxable portion of the distribution, and

"(B) if the fair market value of such property exceeds its adjusted basis in the hands of the trust, gain shall be recognized to the trust as if such property were sold to the expatriate at its fair market value.

"(2) TAXABLE PORTION.—For purposes of this subsection, the term 'taxable portion' means, with respect to any distribution, that portion of the distribution which would be includible in the gross income of the covered expatriate if such expatriate continued to be subject to tax as a citizen or resident of the United States.

"(3) NONGRANTOR TRUST.—For purposes of this subsection, the term 'nongrantor trust' means the portion of any trust that the individual is not considered the owner of under subpart E of part I of subchapter J. The determination under the preceding sentence shall be made immediately before the expatriation date.

"(4) SPECIAL RULES RELATING TO WITHHOLDING.—For purposes of this subsection—

"(A) rules similar to the rules of subsection (d)(6) shall apply, and

"(B) the covered expatriate shall be treated as having waived any right to claim any reduction under any treaty with the United States in withholding on any distribution to which paragraph (1)(A) applies.

"(5) APPLICATION.—This subsection shall apply to a nongrantor trust only if the covered expatriate was a beneficiary of the trust on the day before the expatriation date.

"(g) DEFINITIONS AND SPECIAL RULES RELATING TO EXPATRIATION.—For purposes of this section—

"(1) COVERED EXPATRIATE.—

"(A) IN GENERAL.—The term 'covered expatriate' means an expatriate who meets the requirements of subparagraph (A), (B), or (C) of section 877(a)(2).

"(B) EXCEPTIONS.—An individual shall not be treated as meeting the requirements of subparagraph (A) or (B) of section 877(a)(2) if—

"(i) the individual—

"(I) became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and

"(II) has been a resident of the United States (as defined in section 7701(b)(1)(A)(ii)) for not more than 10 taxable years during the 15-taxable year period ending with the taxable year during which the expatriation date occurs, or

"(ii)(I) the individual's relinquishment of United States citizenship occurs before such individual attains age 18½, and

"(II) the individual has been a resident of the United States (as so defined) for not more than 10 taxable years before the date of relinquishment.

"(C) COVERED EXPATRIATES ALSO SUBJECT TO TAX AS CITIZENS OR RESIDENTS.—In the case of any covered expatriate who is subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, such individual shall not be treated as a covered expatriate during such period for purposes of subsections (d)(1) and (f) and section 2801.

"(2) EXPATRIATE.—The term 'expatriate' means—

"(A) any United States citizen who relinquishes his citizenship, and

"(B) any long-term resident of the United States who ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)).

"(3) EXPATRIATION DATE.—The term 'expatriation date' means—

"(A) the date an individual relinquishes United States citizenship, or

"(B) in the case of a long-term resident of the United States, the date on which the individual ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)).

"(4) RELINQUISHMENT OF CITIZENSHIP.—A citizen shall be treated as relinquishing his United States citizenship on the earliest of—

"(A) the date the individual renounces his United States nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5)),

"(B) the date the individual furnishes to the United States Department of State a signed statement of voluntary relinquishment of United States nationality confirming the performance of an act of expatriation specified in paragraph (1), (2), (3), or (4) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(1)–(4)),

"(C) the date the United States Department of State issues to the individual a certificate of loss of nationality, or

"(D) the date a court of the United States cancels a naturalized citizen's certificate of naturalization.

Subparagraph (A) or (B) shall not apply to any individual unless the renunciation or voluntary relinquishment is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the United States Department of State.

"(5) LONG-TERM RESIDENT.—The term 'long-term resident' has the meaning given to such term by section 877(e)(2).

"(6) EARLY DISTRIBUTION TAX.—The term 'early distribution tax' means any increase in tax imposed under section 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4).

"(h) OTHER RULES.—

"(1) TERMINATION OF DEFERRALS, ETC.—In the case of any covered expatriate, notwithstanding any other provision of this title—

"(A) any time period for acquiring property which would result in the reduction in the amount of gain recognized with respect to property disposed of by the taxpayer shall terminate on the day before the expatriation date, and

"(B) any extension of time for payment of tax shall cease to apply on the day before the expatriation date and the unpaid portion of such tax shall be due and payable at the time and in the manner prescribed by the Secretary.

"(2) STEP-UP IN BASIS.—Solely for purposes of determining any tax imposed by reason of subsection (a), property which was held by an individual on the date the individual first became a resident of the United States (within the meaning of section 7701(b)) shall be treated as having a basis on such date of not less than the fair market value of such property on such date. The preceding sentence shall not apply if the individual elects not to have such sentence apply. Such an election, once made, shall be irrevocable.

"(3) COORDINATION WITH SECTION 684.—If the expatriation of any individual would result in the recognition of gain under section 684, this section shall be applied after the application of section 684.

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.".

(b) TAX ON GIFTS AND BEQUESTS RECEIVED BY UNITED STATES CITIZENS AND RESIDENTS FROM EXPATRIATES.—

(1) IN GENERAL.—Subtitle B (relating to estate and gift taxes) is amended by inserting after chapter 14 the following new chapter:

"CHAPTER 15—GIFTS AND BEQUESTS FROM EXPATRIATES

"SEC. 2801. IMPOSITION OF TAX.

"(a) IN GENERAL.—If, during any calendar year, any United States citizen or resident receives any covered gift or bequest, there is hereby imposed a tax equal to the product of—

"(1) the highest rate of tax specified in the table contained in section 2001(c) as in effect on the date of such receipt (or, if greater, the highest rate of tax specified in the table applicable under section 2502(a) as in effect on the date), and

"(2) the value of such covered gift or bequest.

"(b) TAX TO BE PAID BY RECIPIENT.—The tax imposed by subsection (a) on any covered gift or bequest shall be paid by the person receiving such gift or bequest.

"(c) EXCEPTION FOR CERTAIN GIFTS.—Subsection (a) shall apply only to the extent that the value of covered gifts and bequests received by any person during the calendar year exceeds $10,000.

"(d) TAX REDUCED BY FOREIGN GIFT OR ESTATE TAX.—The tax imposed by subsection (a) on any covered gift or bequest shall be reduced by the amount of any gift or estate tax paid to a foreign country with respect to such covered gift or bequest.

"(e) COVERED GIFT OR BEQUEST.—

"(1) IN GENERAL.—For purposes of this chapter, the term 'covered gift or bequest' means—

"(A) any property acquired by gift directly or indirectly from an individual who, at the time of such acquisition, is a covered expatriate, and

"(B) any property acquired directly or indirectly by reason of the death of an individual who, immediately before such death, was a covered expatriate.

"(2) EXCEPTIONS FOR TRANSFERS OTHERWISE SUBJECT TO ESTATE OR GIFT TAX.—Such term shall not include—

"(A) any property shown on a timely filed return of tax imposed by chapter 12 which is a taxable gift by the covered expatriate, and

"(B) any property included in the gross estate of the covered expatriate for purposes of chapter 11 and shown on a timely filed return of tax imposed by chapter 11 of the estate of the covered expatriate.

"(3) TRANSFERS IN TRUST.—

"(A) DOMESTIC TRUSTS.—In the case of a covered gift or bequest made to a domestic trust—

"(i) subsection (a) shall apply in the same manner as if such trust were a United States citizen, and

"(ii) the tax imposed by subsection (a) on such gift or bequest shall be paid by such trust.

"(B) FOREIGN TRUSTS.—

"(i) IN GENERAL.—In the case of a covered gift or bequest made to a foreign trust, subsection (a) shall apply to any distribution attributable to such gift or bequest from such trust (whether from income or corpus) to a United States citizen or resident in the same manner as if such distribution were a covered gift or bequest.

"(ii) DEDUCTION FOR TAX PAID BY RECIPIENT.—There shall be allowed as a deduction under section 164 the amount of tax imposed by this section which is paid or accrued by a United States citizen or resident by reason of a distribution from a foreign trust, but only to the extent such tax is imposed on the portion of such distribution which is included in the gross income of such citizen or resident.

"(iii) ELECTION TO BE TREATED AS DOMESTIC TRUST.—Solely for purposes of this section, a foreign trust may elect to be treated as a domestic trust. Such an election may be revoked with the consent of the Secretary.

"(f) COVERED EXPATRIATE.—For purposes of this section, the term 'covered expatriate' has the meaning given to such term by section 877A(g)(1).".

(2) CLERICAL AMENDMENT.—The table of chapters for subtitle B is amended by inserting after the item relating to chapter 14 the following new item:

"CHAPTER 15. GIFTS AND BEQUESTS FROM EXPATRIATES.".

(c) DEFINITION OF TERMINATION OF UNITED STATES CITIZENSHIP.—

(1) IN GENERAL.—Section 7701(a) is amended by adding at the end the following new paragraph:

"(50) TERMINATION OF UNITED STATES CITIZENSHIP.—

"(A) IN GENERAL.—An individual shall not cease to be treated as a United States citizen before the date on which the individual's citizenship is treated as relinquished under section 877A(g)(4).

"(B) DUAL CITIZENS.—Under regulations prescribed by the Secretary, subparagraph (A) shall not apply to an individual who became at birth a citizen of the United States and a citizen of another country.".

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (1) of section 877(e) is amended to read as follows:

"(1) IN GENERAL.—Any long-term resident of the United States who ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)) shall be treated for purposes of this section and sections 2107, 2501, and 6039G in the same manner as if such resident were a citizen of the United States who lost United States citizenship on the date of such cessation or commencement.''.

(B) Paragraph (6) of section 7701(b) is amended by adding at the end the following flush sentence:

"An individual shall cease to be treated as a lawful permanent resident of the United States if such individual commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, does not waive the benefits of such treaty applicable to residents of the foreign country, and notifies the Secretary of the commencement of such treatment.''.

(C) Section 7701 is amended by striking subsection (n) and by redesignating subsections (o) and (p) as subsections (n) and (o), respectively.

(d) INFORMATION RETURNS.—Section 6039G is amended—

(1) by inserting "or 877A" after "section 877(b)" in subsection (a), and

(2) by inserting "or 877A" after "section 877(a)" in subsection (d).

(e) CLERICAL AMENDMENT.—The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by inserting after the item relating to section 877 the following new item:

"Sec. 877A. Tax responsibilities of expatriation.''.

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to expatriates (as defined in section 877A(g) of the Internal Revenue Code of 1986, as added by this section) whose expatriation date (as so defined) is on or after the date of the enactment of this Act.

(2) GIFTS AND BEQUESTS.—Chapter 15 of the Internal Revenue Code of 1986 (as added by subsection (b)) shall apply to covered gifts and bequests (as defined in section 2801 of such Code, as so added) received on or after the date of the enactment of this Act, regardless of when the transferor expatriated.

SEC. 505. REPEAL OF SUSPENSION OF CERTAIN PENALTIES AND INTEREST.

(a) IN GENERAL.—Section 6404 is amended by striking subsection (g) and by redesignating subsection (h) as subsection (g).

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to notices provided by the Secretary of the Treasury, or his delegate, after the date which is 6 months after the date of the enactment of the Small Business and Work Opportunity Tax Act of 2007.

SEC. 506. UNUSED MERCHANDISE DRAWBACK.

(a) IN GENERAL.—Section 313(j)(2) of the Tariff Act of 1930 (19 U.S.C. 1313(j)(2)) is amended by adding at the end the following: "For purposes of subparagraph (A) of this paragraph, wine of the same color having a price variation not to exceed 50 percent between the imported wine and the exported wine shall be deemed to be commercially interchangeable.''.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to claims filed for drawback under section 313(j)(2) of the Tariff Act of 1930 on or after the date of the enactment of this Act.

TITLE VI—REVENUE PROVISIONS

Subtitle A—Nonqualified Deferred Compensation From Certain Tax Indifferent Parties

SEC. 601. NONQUALIFIED DEFERRED COMPENSATION FROM CERTAIN TAX INDIFFERENT PARTIES.

(a) IN GENERAL.—Subpart B of part II of subchapter E of chapter 1 (relating to taxable year for which items of gross income included) is amended by inserting after section 457 the following new section:

"SEC. 457A. NONQUALIFIED DEFERRED COMPENSATION FROM CERTAIN TAX INDIFFERENT PARTIES.

"(a) IN GENERAL.—Any compensation which is deferred under a nonqualified deferred compensation plan of a nonqualified entity shall be taken into account for purposes of this chapter when there is no substantial risk of forfeiture of the rights to such compensation.

"(b) NONQUALIFIED ENTITY.—For purposes of this section, the term 'nonqualified entity' means—

"(1) any foreign corporation unless substantially all of such income is—

"(A) effectively connected with the conduct of a trade or business in the United States, or

"(B) subject to a comprehensive foreign income tax, and

"(2) any partnership unless substantially all of such income is allocated to persons other than—

"(A) foreign persons with respect to whom such income is not subject to a comprehensive foreign income tax, and

"(B) organizations which are exempt from tax under this title.

"(c) ASCERTAINABILITY OF AMOUNTS OF COMPENSATION.—

"(1) IN GENERAL.—If the amount of any compensation is not ascertainable at the time that such compensation is otherwise to be taken into account under subsection (a)—

"(A) such amount shall be so taken into account when ascertainable, and

"(B) the tax imposed under this chapter for the taxable year in which such compensation is taken into account under subparagraph (A) shall be increased by the sum of—

"(i) the amount of interest determined under paragraph (2), and

"(ii) an amount equal to 20 percent of the amount of such compensation.

"(2) INTEREST.—For purposes of paragraph (1)(B)(i), the interest determined under this paragraph for any taxable year is the amount of interest at the underpayment rate under section 6621 plus 1 percentage point on the underpayments that would have occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.

"(d) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) SUBSTANTIAL RISK OF FORFEITURE.—The rights of a person to compensation shall be treated as subject to a substantial risk of forfeiture only if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual.

"(2) COMPREHENSIVE FOREIGN INCOME TAX.—The term 'comprehensive foreign income tax' means, with respect to any foreign person, the income tax of a foreign country if—

"(A) such person is eligible for the benefits of a comprehensive income tax treaty between such foreign country and the United States, or

"(B) such person demonstrates to the satisfaction of the Secretary that such foreign country has a comprehensive income tax.

Such term shall not include any tax unless such tax includes rules for the deductibility of deferred compensation which are similar to the rules of this title.

"(3) NONQUALIFIED DEFERRED COMPENSATION PLAN.—The term 'nonqualified deferred compensation plan' has the meaning given such term under section 409A(d), except that such term shall include any plan that provides a right to compensation based on the appreciation in value of a specified number of equity units of the service recipient.

"(4) APPLICATION OF RULES.—Rules similar to the rules of paragraphs (5) and (6) of section 409A(d) shall apply.

"(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations disregarding a substantial risk of forfeiture in cases where necessary to carry out the purposes of this section.".

(b) CONFORMING AMENDMENT.—Section 26(b)(2) is amended by striking "and" at the end of subparagraph (S), by striking the period at the end of subparagraph (T) and inserting ", and", and by adding at the end the following new subparagraph:

"(U) section 457A(c)(1)(B) (relating to ascertainability of amounts of compensation).".

(c) CLERICAL AMENDMENT.—The table of sections of subpart B of part II of subchapter E of chapter 1 is amended by inserting after the item relating to section 457 the following new item:

"Sec. 457A. Nonqualified deferred compensation from certain tax indifferent parties.".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to amounts deferred which are attributable to services performed after December 31, 2007.

(2) APPLICATION TO EXISTING DEFERRALS.—In the case of any amount deferred to which the amendments made by this section do not apply solely by

reason of the fact that the amount is attributable to services performed before January 1, 2008, to the extent such amount is not includible in gross income in a taxable year beginning before 2017, such amounts shall be includible in gross income in the later of—

(A) the last taxable year beginning before 2017, or

(B) the taxable year in which there is no substantial risk of forfeiture of the rights to such compensation (determined in the same manner as determined for purposes of section 457A of the Internal Revenue Code of 1986, as added by this section).

(3) ACCELERATED PAYMENTS.—No later than 60 days after the date of the enactment of this Act, the Secretary shall issue guidance providing a limited period of time during which a nonqualified deferred compensation arrangement attributable to services performed on or before December 31, 2007, may, without violating the requirements of section 409A(a) of the Internal Revenue Code of 1986, be amended to conform the date of distribution to the date the amounts are required to be included in income.

Subtitle B—Provisions Related to Certain Investment Partnerships

SEC. 611. INCOME OF PARTNERS FOR PERFORMING INVESTMENT MANAGEMENT SERVICES TREATED AS ORDINARY INCOME RECEIVED FOR PERFORMANCE OF SERVICES.

(a) IN GENERAL.—Part I of subchapter K of chapter 1 is amended by adding at the end the following new section:

"SEC. 710. SPECIAL RULES FOR PARTNERS PROVIDING INVESTMENT MANAGEMENT SERVICES TO PARTNERSHIP.

"(a) TREATMENT OF DISTRIBUTIVE SHARE OF PARTNERSHIP ITEMS.—For purposes of this title, in the case of an investment services partnership interest—

"(1) IN GENERAL.—Notwithstanding section 702(b)—

"(A) any net income with respect to such interest for any partnership taxable year shall be treated as ordinary income for the performance of services, and

"(B) any net loss with respect to such interest for such year, to the extent not disallowed under paragraph (2) for such year, shall be treated as an ordinary loss.

"(2) TREATMENT OF LOSSES.—

"(A) LIMITATION.—Any net loss with respect to such interest shall be allowed for any partnership taxable year only to the extent that such loss does not exceed the excess (if any) of—

"(i) the aggregate net income with respect to such interest for all prior partnership taxable years, over

"(ii) the aggregate net loss with respect to such interest not disallowed under this subparagraph for all prior partnership taxable years.

"(B) CARRYFORWARD.—Any net loss for any partnership taxable year which is not allowed by reason of subparagraph (A) shall be treated as an item of loss with respect to such partnership interest for the succeeding partnership taxable year.

"(C) BASIS ADJUSTMENT.—No adjustment to the basis of a partnership interest shall be made on account of any net loss which is not allowed by reason of subparagraph (A).

"(D) EXCEPTION FOR BASIS ATTRIBUTABLE TO PURCHASE OF A PARTNERSHIP INTEREST.—In the case of an investment services partnership interest acquired by purchase, paragraph (1)(B) shall not apply to so much of any net loss with respect to such interest for any taxable year as does not exceed the excess of—

"(i) the basis of such interest immediately after such purchase, over

"(ii) the aggregate net loss with respect to such interest to which paragraph (1)(B) did not apply by reason of this subparagraph for all prior taxable years.

Any net loss to which paragraph (1)(B) does not apply by reason of this subparagraph shall not be taken into account under subparagraph (A).

"(E) PRIOR PARTNERSHIP YEARS.—Any reference in this paragraph to prior partnership taxable years shall only include prior partnership taxable years to which this section applies.

"(3) NET INCOME AND LOSS.—For purposes of this section—

"(A) NET INCOME.—The term 'net income' means, with respect to any investment services partnership interest, for any partnership taxable year, the excess (if any) of—

"(i) all items of income and gain taken into account by the holder of such interest under section 702 with respect to such interest for such year, over

"(ii) all items of deduction and loss so taken into account.

"(B) NET LOSS.—The term 'net loss' means with respect to such interest for such year, the excess (if any) of the amount described in subparagraph (A)(ii) over the amount described in subparagraph (A)(i).

"(b) DISPOSITIONS OF PARTNERSHIP INTERESTS.—

"(1) GAIN.—Any gain on the disposition of an investment services partnership interest shall be treated as ordinary income for the performance of services.

"(2) LOSS.—Any loss on the disposition of an investment services partnership interest shall be treated as an ordinary loss to the extent of the excess (if any) of—

"(A) the aggregate net income with respect to such interest for all partnership taxable years, over

"(B) the aggregate net loss with respect to such interest allowed under subsection (a)(2) for all partnership taxable years.

"(3) DISPOSITION OF PORTION OF INTEREST.—In the case of any disposition of an investment services partnership interest, the amount of net loss which otherwise would have (but for subsection (a)(2)(C)) applied to reduce the basis of such interest shall be disregarded for purposes of this section for all succeeding partnership taxable years.

"(4) DISTRIBUTIONS OF PARTNERSHIP PROPERTY.—In the case of any distribution of appreciated property by a partnership with respect to any investment services partnership interest, gain shall be recognized by the partnership in the same manner as if the partnership sold such property at fair market value at the time of the distribution. For purposes of this paragraph, the term 'appreciated property' means any property with respect to which gain would be determined if sold as described in the preceding sentence.

"(5) APPLICATION OF SECTION 751.—In applying section 751(a), an investment services partnership interest shall be treated as an inventory item.

"(c) INVESTMENT SERVICES PARTNERSHIP INTEREST.—For purposes of this section—

"(1) IN GENERAL.—The term 'investment services partnership interest' means any interest in a partnership which is held by any person if such person provides (directly or indirectly) a substantial quantity of any of the following services with respect to the assets of the partnership in the conduct of the trade or business of providing such services:

"(A) Advising as to the advisability of investing in, purchasing, or selling any specified asset.

"(B) Managing, acquiring, or disposing of any specified asset.

"(C) Arranging financing with respect to acquiring specified assets.

"(D) Any activity in support of any service described in subparagraphs (A) through (C).

For purposes of this paragraph, the term 'specified asset' means securities (as defined in section 475(c)(2) without regard to the last sentence thereof), real estate, commodities (as defined in section 475(e)(2))), or options or derivative contracts with respect to securities (as so defined), real estate, or commodities (as so defined).

"(2) EXCEPTION FOR CERTAIN CAPITAL INTERESTS.—

"(A) IN GENERAL.—If—

"(i) a portion of an investment services partnership interest is acquired on account of a contribution of invested capital, and

"(ii) the partnership makes a reasonable allocation of partnership items between the portion of the distributive share that is with respect to invested capital and the portion of such distributive share that is not with respect to invested capital,

then subsection (a) shall not apply to the portion of the distributive share that is with respect to invested capital. An allocation will not be treated as reasonable for purposes of this subparagraph if such allocation would result in the partnership allocating a greater portion of income to invested capital than any other partner not providing services would have been allocated with respect to the same amount of invested capital.

"(B) SPECIAL RULE FOR DISPOSITIONS.—In any case to which subparagraph (A) applies, subsection (b) shall not apply to any gain or loss allocable to invested capital. The portion of any gain or loss attributable to invested capital is the proportion of such gain or loss which is based on the distributive share of gain or loss that would have been allocable to invested capital under subparagraph (A) if the partnership sold all of its assets immediately before the disposition.

"(C) INVESTED CAPITAL.—For purposes of this paragraph, the term 'invested capital' means, the fair market value at the time of contribution of any money or other property contributed to the partnership.

"(D) TREATMENT OF CERTAIN LOANS.—

"(i) PROCEEDS OF PARTNERSHIP LOANS NOT TREATED AS INVESTED CAPITAL OF SERVICE PROVIDING PARTNERS.—For purposes of this paragraph, an investment services partnership interest shall not be treated as acquired on account of a contribution of invested capital to the extent that such capital is attributable to the proceeds of any loan or other advance made or guaranteed, directly or indirectly, by any partner or the partnership.

"(ii) LOANS FROM NONSERVICE PROVIDING PARTNERS TO THE PARTNERSHIP TREATED AS INVESTED CAPITAL.—For purposes of this paragraph, any loan or other advance to the partnership made or guaranteed, directly or indirectly, by a partner not providing services to the partnership shall be treated as invested capital of such partner and amounts of income and loss treated as allocable to invested capital shall be adjusted accordingly.

"(d) OTHER INCOME AND GAIN IN CONNECTION WITH INVESTMENT MANAGEMENT SERVICES.—

"(1) IN GENERAL.—If—

"(A) a person performs (directly or indirectly) investment management services for any entity,

"(B) such person holds a disqualified interest with respect to such entity, and

"(C) the value of such interest (or payments thereunder) is substantially related to the amount of income or gain (whether or not realized) from the assets with respect to which the investment management services are performed,

any income or gain with respect to such interest shall be treated as ordinary income for the performance of services. Rules similar to the rules of subsection (c)(2) shall apply where such interest was acquired on account of invested capital in such entity.

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) DISQUALIFIED INTEREST.—The term 'disqualified interest' means, with respect to any entity—

"(i) any interest in such entity other than indebtedness,

"(ii) convertible or contingent debt of such entity,

"(iii) any option or other right to acquire property described in clause (i) or (ii), and

"(iv) any derivative instrument entered into (directly or indirectly) with such entity or any investor in such entity.

Such term shall not include a partnership interest and shall not include stock in a taxable corporation.

"(B) TAXABLE CORPORATION.—The term 'taxable corporation' means—

"(i) a domestic C corporation, or

"(ii) a foreign corporation subject to a comprehensive foreign income tax (as defined in section 457A(d)(4)).

"(C) INVESTMENT MANAGEMENT SERVICES.—The term 'investment management services' means a substantial quantity of any of the services described in subsection (c)(1) which are provided in the conduct of the trade or business of providing such services.

"(e) REGULATIONS.—The Secretary shall prescribe such regulations as are necessary or appropriate to carry out the purposes of this section, including regulations to—

"(1) prevent the avoidance of the purposes of this section, and

"(2) coordinate this section with the other provisions of this subchapter.

"(f) CROSS REFERENCE.—For 40 percent no fault penalty on certain underpayments due to the avoidance of this section, see section 6662.".

(b) APPLICATION TO REAL ESTATE INVESTMENT TRUSTS.—Subsection (c) of section 856 is amended by adding at the end the following new paragraph:

"(8) EXCEPTION FROM RECHARACTERIZATION OF INCOME FROM INVESTMENT SERVICES PARTNERSHIP INTERESTS.—

"(A) IN GENERAL.—Paragraphs (2), (3), and (4) shall be applied without regard to section 710 (relating to special rules for partners providing investment management services to partnership).

"(B) SPECIAL RULE FOR PARTNERSHIPS OWNED BY REITS.—Section 7704 shall be applied without regard to section 710 in the case of a partnership which meets each of the following requirements:

"(i) Such partnership is treated as publicly traded under section 7704 solely by reason of interests in such partnership being convertible into interests in a real estate investment trust which is publicly traded.

"(ii) 50 percent or more of the capital and profits interests of such partnership are owned, directly or indirectly, at all times during the taxable year by such real estate investment trust (determined with the application of section 267(c)).

"(iii) Such partnership meets the requirements of paragraphs (2), (3), and (4) (applied without regard to section 710).".

(c) IMPOSITION OF PENALTY ON UNDERPAYMENTS.—

(1) IN GENERAL.—Subsection (b) of section 6662 is amended by inserting after paragraph (5) the following new paragraph:

"(6) The application of subsection (d) of section 710 or the regulations prescribed under section 710(e) to prevent the avoidance of the purposes of section 710.".

(2) AMOUNT OF PENALTY.—

(A) IN GENERAL.—Section 6662 is amended by adding at the end the following new subsection:

"(i) INCREASE IN PENALTY IN CASE OF PROPERTY TRANSFERRED FOR INVESTMENT MANAGEMENT SERVICES.—In the case of any portion of an underpayment to which this section applies by reason of subsection (b)(6), subsection (a) shall be applied with respect to such portion by substituting '40 percent' for '20 percent'.".

(B) CONFORMING AMENDMENTS.—Subparagraph (B) of section 6662A(e)(2) is amended—

(i) by striking "section 6662(h)" and inserting "subsection (h) or (i) of section 6662", and

(ii) by striking "GROSS VALUATION MISSTATEMENT PENALTY" in the heading and inserting "CERTAIN INCREASED UNDERPAYMENT PENALTIES".

(3) REASONABLE CAUSE EXCEPTION NOT APPLICABLE.—Subsection (c) of section 6664 is amended—

(A) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively,

(B) by striking "paragraph (2)" in paragraph (4), as so redesignated, and inserting "paragraph (3)", and

(C) by inserting after paragraph (1) the following new paragraph:

"(2) EXCEPTION.—Paragraph (1) shall not apply to any portion of an underpayment to which this section applies by reason of subsection (b)(6).".

(d) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 731 is amended by inserting "section 710(b)(4) (relating to distributions of partnership property)," before "section 736".

(2) Section 741 is amended by inserting "or section 710 (relating to special rules for partners providing investment management services to partnership)" before the period at the end.

(3) Paragraph (13) of section 1402(a) is amended—

(A) by striking "other than guaranteed" and inserting "other than—

"(A) guaranteed",

(B) by striking the semi-colon at the end and inserting ", and", and

(C) by adding at the end the following new subparagraph:

"(B) any income treated as ordinary income under section 710 received by an individual who provides investment management services (as defined in section 710(d)(2));".

(4) Paragraph (12) of section 211(a) of the Social Security Act is amended—

(A) by striking "other than guaranteed" and inserting "other than—

"(A) guaranteed",

(B) by striking the semi-colon at the end and inserting ", and", and

(C) by adding at the end the following new subparagraph:

"(B) any income treated as ordinary income under section 710 of the Internal Revenue Code of 1986 received by an individual who provides investment management services (as defined in section 710(d)(2) of such Code);".

(5) The table of sections for part I of subchapter K of chapter 1 is amended by adding at the end the following new item:

"Sec. 710. Special rules for partners providing investment management services to partnership.".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years ending after November 1, 2007.

(2) PARTNERSHIP TAXABLE YEARS WHICH INCLUDE EFFECTIVE DATE.—In applying section 710(a) of the Internal Revenue Code of 1986 (as added by this section) in the case of any partnership taxable year which includes November 1, 2007, the amount of the net income referred to in such section shall be treated as being the lesser of the net income for the entire partnership taxable year or the net income determined by only taking into account items attributable to the portion of the partnership taxable year which is after such date.

(3) DISPOSITIONS OF PARTNERSHIP INTERESTS.—Section 710(b) of the Internal Revenue Code of 1986 (as added by this section) shall apply to dispositions and distributions after November 1, 2007.

(4) OTHER INCOME AND GAIN IN CONNECTION WITH INVESTMENT MANAGEMENT SERVICES.—Section 710(d) of such Code (as added by this section) shall take effect on November 1, 2007.

(5) PUBLICLY TRADED PARTNERSHIPS.—For purposes of applying section 7704, the amendments made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 612. INDEBTEDNESS INCURRED BY A PARTNERSHIP IN ACQUIRING SECURITIES AND COMMODITIES NOT TREATED AS ACQUISITION INDEBTEDNESS FOR ORGANIZATIONS WHICH ARE PARTNERS WITH LIMITED LIABILITY.

(a) IN GENERAL.—Subsection (c) of section 514 (relating to acquisition indebtedness) is amended by adding at the end the following new paragraph:

"(10) SECURITIES AND COMMODITIES ACQUIRED BY PARTNERSHIPS IN WHICH AN ORGANIZATION IS A PARTNER WITH LIMITED LIABILITY.—

"(A) IN GENERAL.—In the case of any organization which is a partner with limited liability in a partnership, the term 'acquisition indebtedness' does not, for purposes of this section, include indebtedness incurred or continued by such partnership in purchasing or carrying any qualified security or commodity.

"(B) QUALIFIED SECURITY OR COMMODITY.—For purposes of this paragraph, the term 'qualified security or commodity' means any security (as defined in section 475(c)(2) without regard to the last sentence thereof), any commodity (as defined in section 475(e)(2)), or any option or derivative contract with respect to such a security or commodity.

"(C) APPLICATION TO TIERED PARTNERSHIPS AND OTHER PASS-THRU ENTITIES.—Rules similar to the rules of subparagraph (A) shall apply in the case of tiered partnerships and other pass-thru entities.

"(D) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations to prevent the abuse of this paragraph.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 613. APPLICATION TO PARTNERSHIP INTERESTS AND TAX SHARING AGREEMENTS OF RULE TREATING CERTAIN GAIN ON SALES BETWEEN RELATED PERSONS AS ORDINARY INCOME.

(a) PARTNERSHIP INTERESTS.—Subsection (a) of section 1239 is amended to read as follows:

"(a) TREATMENT OF GAIN AS ORDINARY INCOME.—In the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if—

"(1) such property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation provided in section 167, or

"(2) such property is an interest in a partnership, but only to the extent of gain attributable to unrealized appreciation in property which is of a character subject to the allowance for depreciation provided in section 167.".

(b) TAX SHARING AGREEMENTS.—Section 1239 (relating to gain from sale of depreciable property between certain related taxpayers) is amended by adding at the end the following new subsection:

"(f) APPLICATION TO TAX SHARING AGREEMENTS.—

"(1) IN GENERAL.—If there is a tax sharing agreement with respect to any sale or exchange, the transferee and the transferor shall be treated as related persons for purposes of this section.

"(2) TAX SHARING AGREEMENT.—For purposes of this subsection, the term 'tax sharing agreement' means any agreement which provides for the payment to the transferor of any amount which is determined by reference to any portion of the tax benefit realized by the transferee with respect to the depreciation (or amortization) of the property transferred.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to sales and exchanges after the date of the enactment of this Act.

(2) EXCEPTION FOR BINDING CONTRACTS.—The amendment made by subsection (b) shall not apply to any sale or exchange pursuant to a written binding contract which includes a tax sharing agreement and which is in effect on November 1, 2007, and not modified thereafter in any material respect.

Subtitle C—Other Provisions

SEC. 621. DELAY IN APPLICATION OF WORLDWIDE ALLOCATION OF INTEREST.

(a) IN GENERAL.—Paragraphs (5)(D) and (6) of section 864(f) are each amended by striking "December 31, 2008" and inserting "December 31, 2017".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2008.

SEC. 622. BROKER REPORTING OF CUSTOMER'S BASIS IN SECURITIES TRANSACTIONS.

(a) IN GENERAL.—

(1) BROKER REPORTING FOR SECURITIES TRANSACTIONS.—Section 6045 (relating to returns of brokers) is amended by adding at the end the following new subsection:

"(g) ADDITIONAL INFORMATION REQUIRED IN THE CASE OF SECURITIES TRANSACTIONS.—

"(1) IN GENERAL.—If a broker is otherwise required to make a return under subsection (a) with respect to the gross proceeds of the sale of a covered security, the broker shall include in such return the information described in paragraph (2).

"(2) ADDITIONAL INFORMATION REQUIRED.—

"(A) IN GENERAL.—The information required under paragraph (1) to be shown on a return with respect to a covered security of a customer shall include the customer's adjusted basis in such security and whether any gain or loss with respect to such security is long-term or short-term (within the meaning of section 1222).

"(B) DETERMINATION OF ADJUSTED BASIS.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The customer's adjusted basis shall be determined—

"(I) in the case of any stock (other than any stock in an open-end fund), in accordance with the first-in first-out method unless the customer notifies the broker by means of making an adequate identification of the stock sold or transferred,

"(II) in the case of any stock in an open-end fund acquired before January 1, 2011, in accordance with any acceptable method under section 1012 with respect to the account in which such interest is held,

"(III) in the case of any stock in an open-end fund acquired after December 31, 2010, in accordance with the broker's default method unless the customer notifies the broker that he elects another acceptable method under section 1012 with respect to the account in which such interest is held, and

"(IV) in any other case, under the method for making such determination under section 1012.

"(ii) EXCEPTION FOR WASH SALES.—Except as otherwise provided by the Secretary, the customer's adjusted basis shall be determined without regard to section 1091 (relating to loss from wash sales of stock or securities) unless the transactions occur in the same account with respect to identical securities.

"(3) COVERED SECURITY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'covered security' means any specified security acquired on or after the applicable date if such security—

"(i) was acquired through a transaction in the account in which such security is held, or

"(ii) was transferred to such account from an account in which such security was a covered security, but only if the broker received a statement under section 6045A with respect to the transfer.

"(B) SPECIFIED SECURITY.—The term 'specified security' means—

"(i) any share of stock in a corporation,

"(ii) any note, bond, debenture, or other evidence of indebtedness,

"(iii) any commodity, or contract or derivative with respect to such commodity, if the Secretary determines that adjusted basis reporting is appropriate for purposes of this subsection, and

"(iv) any other financial instrument with respect to which the Secretary determines that adjusted basis reporting is appropriate for purposes of this subsection.

"(C) APPLICABLE DATE.—The term 'applicable date' means—

"(i) January 1, 2009, in the case of any specified security which is stock in a corporation, and

"(ii) January 1, 2011, or such later date determined by the Secretary in the case of any other specified security.

"(4) OPEN-END FUND.—For purposes of this subsection, the term 'open-end fund' means a regulated investment company (as defined in section 851) which is offering for sale or has outstanding any redeemable security of which it is the issuer and the shares of which are not traded on an established securities exchange.".

(2) BROKER INFORMATION REQUIRED WITH RESPECT TO OPTIONS.—Section 6045, as amended by subsection (a), is amended by adding at the end the following new subsection:

"(h) APPLICATION TO OPTIONS ON COVERED SECURITIES.—

"(1) EXERCISE OF OPTION.—For purposes of this section, in the case of any exercise of an option on a covered security where the taxpayer is the grantor of the option and the option was acquired in the same account as the covered security, the amount received for the grant of an option on a covered security shall be treated as an adjustment to gross proceeds or as an adjustment to basis, as the case may be. A similar rule shall apply in the case of the exercise of an option where the taxpayer is not the grantor of the option.

"(2) LAPSE OR CLOSING TRANSACTION.—For purposes of this section, in the case of the lapse (or closing transaction (as defined in section 1234(b)(2)(A))) of an option on a covered security where the taxpayer is the grantor of the option, this section shall apply as if the premium received for such option were gross proceeds received on the date of the lapse or closing transaction, and the cost (if any) of the closing transaction shall be taken into account as adjusted basis. A similar rule shall apply in the case of a lapse or closing transaction where the taxpayer is not the grantor of the option.

"(3) PROSPECTIVE APPLICATION.—Paragraphs (1) and (2) shall not apply to any option which is granted or acquired before January 1, 2011.

"(4) COVERED SECURITY.—For purposes of this subsection, the term 'covered security' shall have the meaning given such term in subsection (g)(3).".

(3) EXTENSION OF PERIOD FOR STATEMENTS SENT TO CUSTOMERS.—

(A) IN GENERAL.—Subsection (b) of section 6045 is amended by striking "January 31" and inserting "February 15".

(B) STATEMENTS RELATED TO SUBSTITUTE PAYMENTS.—Subsection (d) of section 6045 is amended—

(i) by striking "at such time and", and

(ii) by inserting after "other item." the following new sentence: "The written statement required under the preceding sentence shall be furnished on or before February 15 of the year following the calendar year during which such payment was made.".

(C) OTHER STATEMENTS.—Subsection (b) of section 6045 is amended by adding at the end the following: "In the case of a consolidated reporting statement (as defined in regulations) with respect to any account which includes the statement required by this subsection, any statement which would otherwise be required to be furnished on or before January 31 under section 6042(c), 6049(c)(2)(A), or 6050N(b) with respect to any item in such account shall instead be required to be furnished on or before February 15 if furnished as part of such consolidated reporting statement.".

(b) DETERMINATION OF BASIS OF CERTAIN SECURITIES ON ACCOUNT BY ACCOUNT METHOD.—Section 1012 (relating to basis of property–cost) is amended—

(1) by striking "The basis of property" and inserting the following:

"(a) IN GENERAL.—The basis of property",

(2) by striking "The cost of real property" and inserting the following:

"(b) SPECIAL RULE FOR APPORTIONED REAL ESTATE TAXES.—The cost of real property", and

(3) by adding at the end the following new subsection:

"(c) DETERMINATIONS BY ACCOUNT.—

"(1) IN GENERAL.—In the case of the sale, exchange, or other disposition of a specified security on or after the applicable date, the conventions prescribed by regulations under this section shall be applied on an account by account basis.

"(2) APPLICATION TO OPEN-END FUNDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), any stock in an open-end fund acquired before January 1, 2009, shall be treated as a separate account from any such stock acquired on or after such date.

"(B) ELECTION BY OPEN-END FUND FOR TREATMENT AS SINGLE ACCOUNT.—If an open-end fund elects (at such time and in such form and manner as the Secretary may prescribe) to have this subparagraph apply with respect to one or more of its stockholders—

"(i) subparagraph (A) shall not apply with respect to any stock in such fund held by such stockholders, and

"(ii) all stock in such fund which is held by such stockholders shall be treated as covered securities described in section 6045(g)(3) without regard to the date of the acquisition of such stock.

"(3) DEFINITIONS.—For purposes of this section, the terms 'specified security', 'applicable date', and 'open-end fund' shall have the meaning given such terms in section 6045(g).".

(c) INFORMATION BY TRANSFERORS TO AID BROKERS.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 is amended by inserting after section 6045 the following new section:

"SEC. 6045A. INFORMATION REQUIRED IN CONNECTION WITH TRANSFERS OF COVERED SECURITIES TO BROKERS.

"(a) FURNISHING OF INFORMATION.—Every applicable person which transfers to a broker (as defined in section 6045(c)(1)) a security which is a covered security (as defined in section 6045(g)(3)) in the hands of such applicable person shall furnish to such broker a written statement in such manner and setting forth such information as the Secretary may by regulations prescribe for purposes of enabling such broker to meet the requirements of section 6045(g).

"(b) APPLICABLE PERSON.—For purposes of subsection (a), the term 'applicable person' means—

"(1) any broker (as defined in section 6045(c)(1)), and

"(2) any other person as provided by the Secretary in regulations.

"(c) TIME FOR FURNISHING STATEMENT.—Any statement required by subsection (a) shall be furnished not later than the earlier of—

"(1) 45 days after the date of the transfer described in subsection (a), or

"(2) January 15 of the year following the calendar year during which such transfer occurred.".

(2) ASSESSABLE PENALTIES.—Paragraph (2) of section 6724(d) (defining payee statement) is amended by redesignating subparagraphs (I) through (CC) as subparagraphs (J) through (DD), respectively, and by inserting after subparagraph (H) the following new subparagraph:

"(I) section 6045A (relating to information required in connection with transfers of covered securities to brokers).".

(3) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6045 the following new item:

"Sec. 6045A. Information required in connection with transfers of covered securities to brokers.".

(d) ADDITIONAL ISSUER INFORMATION TO AID BROKERS.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 of the Internal Revenue Code of 1986, as amended by subsection (b), is amended by inserting after section 6045A the following new section:

"SEC. 6045B. RETURNS RELATING TO ACTIONS AFFECTING BASIS OF SPECIFIED SECURITIES.

"(a) IN GENERAL.—According to the forms or regulations prescribed by the Secretary, any issuer of a specified security shall make a return setting forth—

"(1) a description of any organizational action which affects the basis of such specified security of such issuer,

"(2) the quantitative effect on the basis of such specified security resulting from such action, and

"(3) such other information as the Secretary may prescribe.

"(b) TIME FOR FILING RETURN.—Any return required by subsection (a) shall be filed not later than the earlier of—

"(1) 45 days after the date of the action described in subsection (a), or

"(2) January 31 of the year following the calendar year during which such action occurred.

"(c) STATEMENTS TO BE FURNISHED TO HOLDERS OF SPECIFIED SECURITIES OR THEIR NOMINEES.—According to the forms or regulations prescribed by the Secretary, every person required to make a return under subsection (a) with respect to a specified security shall furnish to the nominee with respect to the specified security (or certificate holder if there is no nominee) a written statement showing—

"(1) the name, address, and phone number of the information contact of the person required to make such return,

"(2) the information required to be shown on such return with respect to such security, and

"(3) such other information as the Secretary may prescribe.

The written statement required under the preceding sentence shall be furnished to the holder on or before January 31 of the year following the calendar year during which the action described in subsection (a) occurred.

"(d) SPECIFIED SECURITY.—For purposes of this section, the term 'specified security' has the meaning given such term by section 6045(g)(3)(B). No return shall be required under this section with respect to actions described in subsection (a) with respect to a specified security which occur before the applicable date (as defined in section 6045(g)(3)(C) with respect to such security.

"(e) PUBLIC REPORTING IN LIEU OF RETURN.—The Secretary may waive the requirements under subsections (a) and (c) with respect to a specified security, if the person required to make the return under subsection (a) makes publicly available, in such form and manner as the Secretary determines necessary to carry out the purposes of this section—

"(1) the name, address, phone number, and email address of the information contact of such person, and

"(2) the information described in paragraphs (1), (2), and (3) of subsection (a).".

(2) ASSESSABLE PENALTIES.—

(A) Subparagraph (B) of section 6724(d)(1) of such Code (defining information return) is amended by redesignating clauses (iv) through (xix) as clauses (v) through (xx), respectively, and by inserting after clause (iii) the following new clause:

"(iv) section 6045B(a) (relating to returns relating to actions affecting basis of specified securities),".

(B) Paragraph (2) of section 6724(d) of such Code (defining payee statement), as amended by subsection (c)(2), is amended by redesignating subparagraphs (J) through (DD) as subparagraphs (K) through (EE), respectively, and by inserting after subparagraph (I) the following new subparagraph:

"(J) subsections (c) and (e) of section 6045B (relating to returns relating to actions affecting basis of specified securities).".

(3) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 of such Code, as amended by subsection (b)(3), is amended by inserting after the item relating to section 6045A the following new item:

"Sec. 6045B. Returns relating to actions affecting basis of specified securities.".

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 2009.

SEC. 623. MODIFICATION OF PENALTY FOR FAILURE TO FILE PARTNERSHIP RETURNS.

Section 6698 is amended by adding at the end the following new subsection:

"(e) MODIFICATIONS.—In the case of any return required to be filed after the date of the enactment of this subsection—

"(1) the dollar amount in effect under subsection (b)(1) shall be increased by $25, and

"(2) the limitation on the number of months taken into account under subsection (a) shall not be less than 12 months.".

SEC. 624. PENALTY FOR FAILURE TO FILE S CORPORATION RETURNS.

(a) IN GENERAL.—Part I of subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end the following new section:

"SEC. 6699A. FAILURE TO FILE S CORPORATION RETURN.

"(a) GENERAL RULE.—In addition to the penalty imposed by section 7203 (relating to willful failure to file return, supply information, or pay tax), if any S corporation required to file a return under section 6037 for any taxable year—

"(1) fails to file such return at the time prescribed therefor (determined with regard to any extension of time for filing), or

"(2) files a return which fails to show the information required under section 6037,

such S corporation shall be liable for a penalty determined under subsection (b) for each month (or fraction thereof) during which such failure continues (but not to exceed 12 months), unless it is shown that such failure is due to reasonable cause.

"(b) AMOUNT PER MONTH.—For purposes of subsection (a), the amount determined under this subsection for any month is the product of—

"(1) $25, multiplied by

"(2) the number of persons who were shareholders in the S corporation during any part of the taxable year.

"(c) ASSESSMENT OF PENALTY.—The penalty imposed by subsection (a) shall be assessed against the S corporation.

"(d) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a).".

(b) CLERICAL AMENDMENT.—The table of sections for part I of subchapter B of chapter 68 is amended by adding at the end the following new item:

"Sec. 6699A. Failure to file S corporation return.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to returns required to be filed after the date of the enactment of this Act.

SEC. 625. TIME FOR PAYMENT OF CORPORATE ESTIMATED TAXES.

Subparagraph (B) of section 401(1) of the Tax Increase Prevention and Reconciliation Act of 2005 is amended by striking "115 percent" and inserting "181 percent".

I. SUMMARY AND BACKGROUND

A. Purpose and Summary

The bill, H.R. 3996, as amended, (1) provides a one-year increase in the individual AMT exemption amount for taxable years beginning in 2007 and makes certain related changes, (2) extends certain expiring provisions through 2008, and (3) makes other modifications to the tax laws.

Individual AMT Relief

The bill provides that the individual AMT exemption amount for taxable years beginning in 2007 is (1) $66,250, in the case of married individuals filing a joint return and surviving spouses; (2) $44,350 in the case of other unmarried individuals; and (3) $33,125 in the case of married individuals filing separate returns.

For taxable years beginning in 2007, the bill allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits.

The bill also removes certain income limitations on the AMT refundable credit for long-term unused minimum tax credits.

Extension of certain expiring provisions through 2008

The bill extends for one year, through December 31, 2008, the following provisions:

- deduction for State and local sales taxes.
- deduction for qualified tuition and related expenses
- treatment of certain dividends of regulated investment companies
- excise tax provisions relating to mental health parity rules
- encourage contributions of property interests made for conservation purposes
- tax-free distributions form IRAs to certain public charities
- deduction for teacher classroom expenses
- election to include combat pay in earned income for purposes of the earned income tax credit
- use of qualified mortgage bonds to finance residences for veterans without regard to first-time homebuyer requirement
- penalty-free withdrawals from retirement plans for individuals called to active duty
- estate tax look-through for certain RIC stock held by nonresidents
- treatment of certain RIC stock under FIRPTA
- Treatment of State legislators' travel expenses away from home

- the research and experimentation credit
- tax incentives for business activities on Indian reservations
- the new markets tax credit
- tax credit for certain expenditures for maintaining railroad tracks
- fifteen-year cost recovery for leasehold improvements;
- fifteen-year cost recovery for restaurant improvements;
- seven-year recovery period for certain motorsports racetrack property
- expensing of "brownfield" environmental clean up costs
- application of domestic production activity deduction to Puerto Rico
- modification of tax treatment of certain payments to controlling exempt organizations
- authority to issue qualified zone academy bonds;
- tax incentives for the District of Columbia Enterprise Zone;
- possession tax credit with respect to American Samoa;
- the enhanced deduction for corporate donations of food inventory, of book inventories to public schools, and of computer technology and equipment;
- basis of adjustment to stock of S corporations making charitable contributions of property
- extension of work opportunity tax credit to Hurricane Katrina employees
- certain provisions relating to disclosure of confidential taxpayer information
- authority for undercover operations
- increase in limit on cover over of rum excise tax revenues

Other provisions

The bill contains other provisions, as follows:

- Modifies the threshold amount for the refundable child credit
- Additional standard deduction for real property taxes paid by non-itemizers
- Certain provisions for housing-related tax relief
- Repeal of the authority of the Internal Revenue Service ("IRS") to use private debt collection companies, delay of implementation of withholding taxes on government payments, revision of rules on expatriation, and certain related changes
- Changes to the treatment of certain offshore nonqualified deferred compensation arrangements

- Changes to the treatment of income of partners performing investment management services as ordinary income received for the performance of services
- Changes to the treatment of indebtedness incurred by a partnership in acquiring securities and commodities to tax-exempt limited partners
- Application section 1239 to certain sales of partnership interests and sales between parties to a tax-sharing agreement
- Delay of the implementation of the worldwide interest allocation rules
- Broker reporting of customer's basis in securities transactions
- Increase in the penalty for the failure to file partnership returns
- Imposition of a penalty for the failure to file S corporation returns
- Modifications to corporate estimated tax payments

B. Background and Need for Legislation

The provisions approved by the Committee reflect the need to avoid tax increases on families and businesses as a result of provisions that would otherwise expire, as well as other purposes.

C. Legislative History

The Committee on Ways and Means marked up the Temporary Tax Relief Act of 2007 on November 1, 2007, and ordered the bill, as amended, favorably reported.

II. EXPLANATION OF THE BILL

TITLE I – EXTEND ALTERNATIVE MINIMUM TAX RELIEF FOR INDIVIDUALS

1. Extension of alternative minimum relief for nonrefundable personal credits and extension of increased alternative minimum tax exemption amounts (secs. 101 and 102 of the bill and secs. 26 and 55 of the Code)

Present Law

Present law imposes an alternative minimum tax on individuals. The alternative minimum tax is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The present exemption amount is: (1) $62,550 ($45,000 in taxable years beginning after 2006) in the case of married individuals filing a joint return and surviving spouses; (2) $42,500 ($33,750 in taxable years beginning after 2006) in the case of other unmarried individuals; (3) $31,275 ($22,500 in taxable years beginning after 2006) in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, and the D.C. first-time homebuyer credit).

For taxable years beginning before 2007, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

For taxable years beginning after 2006, the nonrefundable personal credits (other than the adoption credit, child credit and saver's credit) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, child credit, and saver's credit are allowed to the full extent of the individual's regular tax and alternative minimum tax.[1]

Reasons for Change

The Committee is concerned about the projected increase in the number of individuals who will be affected by the individual alternative minimum tax for 2007. The provision will reduce the number of individuals who would otherwise be affected be the minimum tax.

Explanation of Provision

The bill provides that the individual AMT exemption amount for taxable years beginning in 2007 is (1) $66,250, in the case of married individuals filing a joint return and surviving spouses; (2) $44,350 in the case of other unmarried individuals; and (3) $33,125 in the case of married individuals filing separate returns.

For taxable years beginning in 2007, the bill allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits.

Effective Date

The provision is effective for taxable years beginning in 2007.

2. Alternative minimum tax credit relief for individuals (sec. 103 of the bill and sec. 53 of the Code)

Present Law

In general

Present law imposes an alternative minimum tax ("AMT") on an individual taxpayer to the extent the taxpayer's tentative minimum tax liability exceeds his or her regular income tax liability. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is the amount by which the alternative minimum taxable income ("AMTI") exceeds an exemption amount.

An individual's AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The individual AMT attributable to deferral adjustments generates a minimum tax credit that is allowable to the extent the regular tax (reduced by other nonrefundable credits) exceeds

[1] The rule applicable to the adoption credit and child credit is subject to the EGTRRA sunset.

the tentative minimum tax in a future taxable year. Unused minimum tax credits are carried forward indefinitely.

AMT treatment of incentive stock options

One of the adjustments in computing AMTI is the tax treatment of the exercise of an incentive stock option. An incentive stock option is an option granted by a corporation in connection with an individual's employment, so long as the option meets certain specified requirements.[2] Under the regular tax, the exercise of an incentive stock option is tax-free if the stock is not disposed of within one year of exercise of the option or within two years of the grant of the option.[3] The individual then computes the long-term capital gain or loss on the sale of the stock using the amount paid for the stock as the cost basis. If the holding period requirements are not satisfied, the individual generally takes into account at the exercise of the option an amount of ordinary income equal to the excess of the fair market value of the stock on the date of exercise over the amount paid for the stock. The cost basis of the stock is increased by the amount taken into account.[4]

Under the individual alternative minimum tax, the exercise of an incentive stock option is treated as the exercise of an option other than an incentive stock option. Under this treatment, generally the individual takes into account as ordinary income for purposes of computing AMTI the excess of the fair market value of the stock at the date of exercise over the amount paid for the stock.[5] When the stock is later sold, for purposes of computing capital gain or loss for purposes of AMTI, the adjusted basis of the stock includes the amount taken into account as AMTI.

The adjustment relating to incentive stock options is a deferral adjustment and therefore generates an AMT credit in the year the stock is sold.[6]

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[2] Sec. 422.

[3] Sec. 421.

[4] If the stock is sold at a loss before the required holding periods are met, the amount taken into account may not exceed the amount realized on the sale over the adjusted basis of the stock. If the stock is sold after the taxable year in which the option was exercised but before the required holding periods are met, the required inclusion is made in the year the stock is sold.

[5] If the stock is sold in the same taxable year the option is exercised, no adjustment in computing AMTI is required.

[6] If the stock is sold for less than the amount paid for the stock, the loss may not be allowed in full in computing AMTI by reason of the $3,000 limit on the deductibility of net capital losses. Thus, the excess of the regular tax over the tentative minimum tax may not reflect the full amount of the loss.

Allowance of long-term unused credits

Under present law, an individual's minimum tax credit allowable for any taxable year beginning after December 31, 2006, and beginning before January 1, 2013, is not less than the "AMT refundable credit amount". The "AMT refundable credit amount" is the greater of (1) the lesser of $5,000 or the long-term unused minimum tax credit, or (2) 20 percent of the long-term unused minimum tax credit. The long-term unused minimum tax credit for any taxable year means the portion of the minimum tax credit attributable to the adjusted net minimum tax for taxable years before the 3rd taxable year immediately preceding the taxable year (assuming the credits are used on a first-in, first-out basis). In the case of an individual whose adjusted gross income for a taxable year exceeds the threshold amount (within the meaning of section 151(d)(3)(C)), the AMT refundable credit amount is reduced by the applicable percentage (within the meaning of section 151(d)(3)(B)). The additional credit allowable by reason of this provision is refundable.

Reasons for Change

The individual alternative minimum tax is intended to accelerate the tax on certain items of income that are deferred under the regular tax by initially imposing a tax and later allowing a minimum tax credit when the deferral ends. One of these items relates to the exercise of incentive stock options. However, because of technical problems, the credit may not be properly allowable where the value of the stock acquired on the exercise of an incentive stock option has declined in value when the stock is sold. In 2006, Congress provided certain relief in these situations. The Committee believes that additional relief should be provided to correct this problem so that taxpayers are not paying tax on "phantom" income attributable to incentive stock options.

Explanation of Provision

The bill generally allows the long-term unused minimum tax credit over two years and eliminates the AGI phase-out. Thus, if an individual has a long-term unused minimum tax credit of $1 million for 2007, the AMT refundable credit amount for 2007 is $500,000 (50 percent of the $1 million long-term unused credit amount for 2007) and the AMT refundable credit amount for 2008 is also $500,000 (the $500,000 amount of the AMT refundable credit amount for 2007 but not in excess of the $500,000 long-term unused minimum tax credit for 2008).

The bill provides that any underpayment of tax outstanding on the date of enactment which is attributable to the application of the minimum tax adjustment for incentive stock options (including any interest or penalty relating thereto) is abated. No credit is allowed with respect to any amount abated.

The bill provides that any interest and penalty paid before the date of enactment with respect to the application of the minimum adjustment for incentive stock options is treated as an amount of adjusted net minimum tax for the taxable year of the underpayment to which the interest or penalty relates for purposes of the minimum tax credit.

Effective Date

The provision generally applies to taxable years beginning after December 31, 2006.

The provision relating to the abatement of interest and penalties takes effect on date of enactment.

TITLE II – ADDITIONAL INDIVIDUAL TAX RELIEF

1. Refundable child credit (sec. 201 of the bill and sec. 24(d) of the Code)

Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000 through 2010, and $500 thereafter. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The credit is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against the regular tax and the alternative minimum tax. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). The threshold dollar amount is $11,750 (2007), and is indexed for inflation.

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit ("EIC").

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EIC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Reasons for Change

The Committee believes it is appropriate to lower the threshold earnings level for the refundable child credit in order to increase the amount of available child credit for lower income households.

Explanation of Provision

The provision modifies the earned income formula for the determination of the refundable child credit to apply to 15 percent of earned income in excess of $8,500 for taxable years beginning in 2008.

Effective Date

The provision is effective for taxable years beginning in 2008.

2. Additional standard deduction for real property taxes for non-itemizers (sec. 202 of the bill and sec. 63 of the Code)

Present Law

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income.

Reasons for Change

The Committee believes an additional standard deduction for real property taxes is appropriate in order to help lessen the impact of rising State and local property tax bills on those with insufficient total deductions to warrant itemizing such deductions.

Explanation of Provision

The provision allows taxpayers an additional standard deduction for State and local real property taxes for taxpayers who claim the regular standard deduction. The additional standard deduction applies only for 2008, and is limited to $350 ($700 in the case of a married individual filing jointly).

Effective Date

The provision applies to taxable years beginning in 2008.

TITLE III – ONE YEAR EXTENDERS

A. Extenders Primarily Affecting Individuals

1. Deduction of State and local general sales taxes (sec. 301 of the bill and sec. 164 of the Code)

Present Law

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning in 2004 and 2005, at the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes. As is the case for State and local income taxes, the itemized deduction for State and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary of the Treasury that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account number of dependents, modified adjusted gross income and rates of State and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. Taxpayers who use the tables created by the Secretary may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

The term "general sales tax" means a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items. However, in the case of items of food, clothing, medical supplies, and motor vehicles, the fact that the tax does not apply with respect to some or all of such items is not taken into account in determining whether the tax applies with respect to a broad range of classes of items, and the fact that the rate of tax applicable with respect to some or all of such items is lower than the general rate of tax is not taken into account in determining whether the tax is imposed at one rate. Except in the case of a lower rate of tax applicable with respect to food, clothing, medical supplies, or motor vehicles, no deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess shall be disregarded and the general rate is treated as the rate of tax.

A compensating use tax with respect to an item is treated as a general sales tax, provided such tax is complementary to a general sales tax and a deduction for sales taxes is allowable with respect to items sold at retail in the taxing jurisdiction that are similar to such item.

Reasons for Change

The Committee believes an extension of the option to deduct State and local sales taxes in lieu of deducting State and local income taxes is appropriate to continue to provide similar Federal tax treatment to residents of States that rely on sales taxes, rather than income taxes, to fund State and local governmental functions.

Explanation of Provision

The present-law provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes is extended for one year (through December 31, 2008).

Effective Date

The provision applies to taxable years beginning after December 31, 2007.

2. Above-the-line deduction for higher education expenses (sec. 302 of the bill and sec. 222 of the Code)

Present Law

An individual is allowed an above-the-line deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[7] Qualified tuition and related expenses are defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution.[8] The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be

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[7] Sec. 222.

[8] The deduction generally is not available for expenses with respect to a course or education involving sports, games, or hobbies, and is not available for student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2007.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual,[9] and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. Savings Bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings account.[10] Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion under section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope credit or Lifetime Learning credit is elected for such taxable year.

Reasons for Change

The Committee observes that the cost of a college education continues to rise, and thus believes that the extension of the qualified tuition deduction is appropriate to mitigate the impact of rising tuition costs on students and their families. The Committee further believes that the tuition deduction provides an important financial incentive for individuals to pursue higher education.

Explanation of Provision

The provision extends the qualified tuition deduction for one year.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007, and prior to January 1, 2009.

3. Extension of special withholding tax rule for interest-related dividends paid by regulated investment companies (sec. 303 of the bill and sec. 871(k) of the Code)

Present Law

In general

Under present law, a regulated investment company ("RIC") that earns certain interest income that would not be subject to U.S. tax if earned by a foreign person directly may, to the extent of such income, designate a dividend it pays as derived from such interest income. A

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[9] Secs. 222(d)(1) and 25A(g)(2).

[10] Sec. 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.

foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, as if the foreign person had earned the interest directly.

Interest-related dividends

Under present law, a RIC may, under certain circumstances, designate all or a portion of a dividend as an "interest-related dividend," by written notice mailed to its shareholders not later than 60 days after the close of its taxable year. In addition, an interest-related dividend received by a foreign person generally is exempt from U.S. gross-basis tax under sections 871(a), 881, 1441 and 1442.

However, this exemption does not apply to a dividend on shares of RIC stock if the withholding agent does not receive a statement, similar to that required under the portfolio interest rules, that the beneficial owner of the shares is not a U.S. person. The exemption does not apply to a dividend paid to any person within a foreign country (or dividends addressed to, or for the account of, persons within such foreign country) with respect to which the Treasury Secretary has determined, under the portfolio interest rules, that exchange of information is inadequate to prevent evasion of U.S. income tax by U.S. persons.

In addition, the exemption generally does not apply to dividends paid to a controlled foreign corporation to the extent such dividends are attributable to income received by the RIC on a debt obligation of a person with respect to which the recipient of the dividend (i.e., the controlled foreign corporation) is a related person. Nor does the exemption generally apply to dividends to the extent such dividends are attributable to income (other than short-term original issue discount or bank deposit interest) received by the RIC on indebtedness issued by the RIC-dividend recipient or by any corporation or partnership with respect to which the recipient of the RIC dividend is a 10-percent shareholder. However, in these two circumstances the RIC remains exempt from its withholding obligation unless the RIC knows that the dividend recipient is such a controlled foreign corporation or 10-percent shareholder. To the extent that an interest-related dividend received by a controlled foreign corporation is attributable to interest income of the RIC that would be portfolio interest if received by a foreign corporation, the dividend is treated as portfolio interest for purposes of the de minimis rules, the high-tax exception, and the same country exceptions of subpart F (see sec. 881(c)(5)(A)).

The aggregate amount designated as interest-related dividends for the RIC's taxable year (including dividends so designated that are paid after the close of the taxable year but treated as paid during that year as described in section 855) generally is limited to the qualified net interest income of the RIC for the taxable year. The qualified net interest income of the RIC equals the excess of: (1) the amount of qualified interest income of the RIC; over (2) the amount of expenses of the RIC properly allocable to such interest income.

Qualified interest income of the RIC is equal to the sum of its U.S.-source income with respect to: (1) bank deposit interest; (2) short term original issue discount that is currently exempt from the gross-basis tax under section 871; (3) any interest (including amounts recognized as ordinary income in respect of original issue discount, market discount, or acquisition discount under the provisions of sections 1271-1288, and such other amounts as regulations may provide) on an obligation which is in registered form, unless it is earned on an obligation issued by a corporation or partnership in which the RIC is a 10-percent shareholder or is contingent interest not treated as portfolio interest under section 871(h)(4); and (4) any interest-related dividend from another RIC.

If the amount designated as an interest-related dividend is greater than the qualified net interest income described above, the portion of the distribution so designated which constitutes an interest-related dividend will be only that proportion of the amount so designated as the amount of the qualified net interest income bears to the amount so designated.

This withholding tax rule for interest-related dividends received from a RIC does not apply to any taxable year of a RIC beginning after December 31, 2007.

Reasons for Change

The committee believes that, to the extent a RIC distributes to a foreign person a dividend attributable to amounts that would have been exempt from U.S. withholding tax had the foreign person received it directly (such as portfolio interest and capital gains, including short-term capital gains), such dividend similarly should be exempt from the U.S. gross-basis withholding tax. Therefore, the committee believes that it is desirable to extend the present law provision for an additional year.

Explanation of Provision

The provision extends the exemption from withholding tax of interest-related dividends received from a RIC to taxable years of a RIC beginning before January 1, 2009.

Effective Date

The provision applies to estates of decedents dying after December 31, 2007.

4. Extension of parity in the application of certain limits to mental health benefits (sec. 304 of the bill and sec. 9812(f) of the Code)

Present Law

The Code, the Employee Retirement Income Security Act of 1974 ("ERISA") and the Public Health Service Act ("PHSA") contain provisions under which group health plans that provide both medical and surgical benefits and mental health benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits ("mental health parity requirements"). In the case of a group health plan which provides benefits for mental health, the mental health parity requirements do not affect the terms and conditions (including cost sharing, limits on numbers of visits or days of coverage, and requirements relating to medical necessity) relating to the amount, duration, or scope of mental health benefits under the plan, except as specifically provided in regard to parity in the imposition of aggregate lifetime limits and annual limits.

The Code imposes an excise tax on group health plans which fail to meet the mental health parity requirements. The excise tax is equal to $100 per day during the period of noncompliance and is generally imposed on the employer sponsoring the plan if the plan fails to meet the requirements. The maximum tax that can be imposed during a taxable year cannot exceed the lesser of 10 percent of the employer's group health plan expenses for the prior year or $500,000. No tax is imposed if the Secretary determines that the employer did not know, and in exercising reasonable diligence would not have known, that the failure existed.

The mental health parity requirements do not apply to group health plans of small employers nor do they apply if their application results in an increase in the cost under a group health plan of at least one percent. Further, the mental health parity requirements do not require group health plans to provide mental health benefits.

The Code, ERISA and PHSA mental health parity requirements are scheduled to expire with respect to benefits for services furnished after December 31, 2007.

Reasons for Change

The Committee recognizes that the Code provisions relating to mental health parity are important to carrying out the purposes of the Mental Health Parity Act. Thus, the Committee believes that extending the Code provisions relating to mental health parity is warranted.

Explanation of Provision

The provision extends the present-law Code excise tax for failure to comply with the mental health parity requirements through December 31, 2008.

Effective Date

The provision is effective for benefits for services furnished after December 31, 2007.

5. Extend the special rule encouraging contributions of capital gain real property for conservation purposes (sec. 305 of the bill and sec. 170 of the Code)

Present Law

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[11]

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[11] Secs. 170, 2055, and 2522, respectively. Unless otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks. For individuals, the amount deductible is a percentage of the taxpayer's contribution base, which is the taxpayer's adjusted gross income computed without regard to any net operating loss carryback. The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. Cash contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50 percent of the taxpayer's contribution base. Cash contributions to private foundations and certain other organizations generally may be deducted up to 30 percent of the taxpayer's contribution base.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity while also either retaining an interest in that property or transferring an interest in that property to a noncharity for less than full and adequate consideration. Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property, and qualified conservation contributions.

Capital gain property

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions. Contributions of capital gain property that exceed the percentage limitation may be carried forward for five years.

Qualified conservation contributions

Qualified conservation contributions are not subject to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Qualified conservation contributions of capital gain property are subject to the same limitations and carryover rules of other charitable contributions of capital gain property.

Special rule regarding contributions of capital gain real property for conservation purposes

In general

Under a temporary provision that is effective for contributions made in taxable years beginning after December 31, 2005,[12] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

Individuals are allowed to carryover any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years.

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carryover the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

[12] Sec. 170(b)(1)(E).

Farmers and ranchers

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the above example, if the individual is a qualified farmer or rancher, in addition to the $50 deduction for non-conservation contributions, an additional $50 for the qualified conservation contribution is allowed and $30 may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[13]

As an additional condition of eligibility for the 100 percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.) Such additional condition does not apply to contributions made on or before August 17, 2006.

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

Termination

The special rule regarding contributions of capital gain real property for conservation purposes does not apply to contributions made in taxable years beginning after December 31, 2007.

Reasons for Change

The Committee believes that the special rule that provides an increased incentive to make charitable contributions of partial interests in real property for conservation purposes is an important way of encouraging conservation and preservation, and should be extended for an additional year.

[13] Sec. 170(b)(2)(B).

Explanation of Provision

The provision extends the special rule regarding contributions of capital gain real property for conservation purposes for contributions made in taxable years beginning before January 1, 2009.

Effective Date

The provision is effective for contributions made in taxable years beginning after December 31, 2007.

6. Tax-free distributions from individual retirement plans for charitable purposes (sec. 306 of the bill and sec. 408 of the Code)

Present Law

In general

If an amount withdrawn from a traditional individual retirement arrangement ("IRA") or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply to the amount withdrawn and the charitable contribution is subject to the normally applicable limitations on deductibility of such contributions. An exception applies in the case of a qualified charitable distribution.

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to a charity described in section 501(c)(3), to certain veterans' organizations, fraternal societies, and cemetery companies,[14] or to a Federal, State, or local governmental entity for exclusively public purposes.[15] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[16]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[17]

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[14] Secs. 170(c)(3)-(5).

[15] Sec. 170(c)(1).

[16] Secs. 170(b) and (e).

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.[18] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[19]

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to private foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions by individuals in excess of the 50-percent, 30-percent, and 20-percent limits may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is indexed annually for inflation. The threshold amount for 2007 is $156,400 ($78,200 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by three percent of adjusted gross income over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. Beginning in 2006, the overall limitation on itemized deductions phases-out for all taxpayers. The overall limitation on itemized deductions is reduced by one-third in taxable years beginning

[17] Sec. 170(a).

[18] Sec. 170(f)(8).

[19] Sec. 6115.

in 2006 and 2007, and by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation on itemized deductions is eliminated for taxable years beginning after December 31, 2009; however, this elimination of the limitation sunsets on December 31, 2010.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[20] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[21] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Individuals also may make nondeductible contributions to a Roth IRA. Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59-½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by the April 1 of the calendar year following the year in which the IRA owner attains age 70-½.[22]

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the remaining nondeductible contributions to the account balance. In making the calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during any taxable year are treated as a single distribution, and the value of the contract, income on the contract, and investment in the contract are computed as of the close of the calendar year.

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[20] Secs. 170(f), 2055(e)(2), and 2522(c)(2).

[21] Sec. 170(f)(2).

[22] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[23] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[24] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

Qualified charitable distributions

Present law provides an exclusion from gross income for otherwise taxable IRA distributions from a traditional or a Roth IRA in the case of qualified charitable distributions.[25] The exclusion may not exceed $100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. Qualified charitable distributions are taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA merely because qualified charitable distributions have been made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (other than an organization described in section 509(a)(3) or a donor advised fund (as defined in section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70-½.

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

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[23] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

[24] Sec. 3405.

[25] The exclusion does not apply to distributions from employer-sponsored retirements plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income (but for the qualified charitable distribution provision) and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income (but for the qualified charitable distribution provision) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under section 170.

The exclusion for qualified charitable distributions applies to distributions made in taxable years beginning after December 31, 2005. Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2007.

Reasons for Change

The Committee believes that facilitating charitable contributions from IRAs will help increase giving to charitable organizations. Therefore, the Committee believes that the present-law exclusion for qualified charitable distributions should be extended for one year.

Explanation of Provision

The provision extends the exclusion for qualified charitable distributions to distributions made in taxable years beginning after December 31, 2007, and before January 1, 2009.

Effective Date

The provision is effective for distributions made in taxable years beginning after December 31, 2007.

7. Deduction for certain expenses of elementary and secondary (sec. 307 of the bill and sec. 62(a)(2) of the Code)

Present Law

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. An individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of $156,400 (for 2007).[26] In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Eligible educators are allowed an above-the-line deduction for certain expenses.[27] Specifically, for taxable years beginning after December 31, 2001, and prior to January 1, 2008, an above-the-line deduction is allowed for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom. To be eligible for this deduction, the expenses must be otherwise deductible under section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under section 135 (relating to education savings bonds), 529(c)(1) (relating to qualified tuition programs), and section 530(d)(2) (relating to Coverdell education savings accounts).

An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. A school means any school that provides elementary education or secondary education, as determined under State law.

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2007.

Reasons for Change

The Committee recognizes that many elementary and secondary school teachers provide substantial classroom resources at their own expense, and believe that it is appropriate to extend the present law deduction for such expenses in order to continue to partially offset the substantial costs such educators incur for the benefit of their students.

Explanation of Provision

The provision extends the deduction for eligible educator expenses for one year.

Effective Date

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2007, and prior to January 1, 2009.

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[26] The adjusted gross income threshold is $78,200 in the case of a married individual filing a separate return (for 2007).

[27] Sec. 62(a)(2)(D).

8. One year extension of the election to treat combat pay as earned income for purposes of the earned income credit (sec. 308 of the bill and sec. 32(c)(2) of the Code)

Present Law

In general

Subject to certain limitations, military compensation earned by members of the Armed Forces while serving in a combat zone may be excluded from gross income. In addition, for up to two years following service in a combat zone, military personnel may also exclude compensation earned while hospitalized from wounds, disease, or injuries incurred while serving in the combat zone.

Child credit

Combat pay that is otherwise excluded from gross income under section 112 is treated as earned income which is taken into account in computing taxable income for purposes of calculating the refundable portion of the child credit.[28]

Earned income credit

Any taxpayer may elect to treat combat pay that is otherwise excluded from gross income under section 112 as earned income for purposes of the earned income credit. This election is available with respect to any taxable year ending after the date of enactment and before January 1, 2008.

Reasons for Change

The Committee believes that members of the armed forces serving in combat should have full availability of the earned income credit, notwithstanding the exclusion of combat pay from gross income for purposes of determining federal tax liability. The Committee believes an extension of the election to treat combat pay as earnings for purposes of the earned income credit is necessary to achieve this result.

Explanation of Provision

The provision extends for one year the availability of the election to treat combat pay that is otherwise excluded from gross income under section 112 as earned income for purposes of the earned income credit.

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[28] Unless otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

Effective Date

The provision is effective in taxable years beginning after December 31, 2007 and before January 1, 2009.

9. Extension of qualified mortgage bond program rules for veterans (sec. 309 of the bill and sec. 143 of the Code)

Present Law

Private activity bonds are bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such private person. The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of a qualified private activity bond includes both qualified mortgage bonds and qualified veterans' mortgage bonds.

Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for homebuyers and purchase price limitations for the home financed with bond proceeds. In addition, qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage (the "first-time homebuyer" requirement).

Under a special rule, qualified mortgage bonds may be issued to finance mortgages for veterans who served in the active military without regard to the first-time homebuyer requirement. Present-law income and purchase price limitations apply to loans to veterans financed with the proceeds of qualified mortgage bonds. Veterans are eligible for the exception from the first-time homebuyer requirement without regard to the date they last served on active duty or the date they applied for a loan after leaving active duty. However, veterans may only use the exception one time. This provision applies to bonds issued before January 1, 2008.

Reasons for Change

The Committee believes that the mortgage bond program provides an effective tool for providing the benefits of homeownership to military veterans. The present-law exception to the first-time homebuyer rule allows a broader class of veterans to benefit from the program and the Committee believes it is appropriate to extend the exception for an additional year.

Explanation of Provision

The provision extends for one year the first-time homebuyer exception for veterans under the qualified mortgage bond program.

Effective Date

The provision applies to bonds issued after December 31, 2007 and before January 1, 2009.

10. Treatment of distributions to individuals called to active duty for at least 180 days (sec. 310 of the bill and sec. 72(t) of the Code)

Present Law

Under present law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception to the tax applies. Among other exceptions, the early distribution tax does not apply to distributions made to an employee who separates from service after age 55, or to distributions that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the employee or the joint lives (or life expectancies) of the employee and his or her beneficiary.

Certain amounts held in a qualified cash or deferred arrangement (a "section 401(k) plan") or in a tax-sheltered annuity (a "section 403(b) annuity") may not be distributed before severance from employment, age 59½, death, disability, or financial hardship of the employee.

Pursuant to amendments to section 72(t) made by the Pension Protection Act of 2006,[29] the 10-percent early withdrawal tax does not apply to a qualified reservist distribution. A qualified reservist distribution is a distribution (1) from an IRA or attributable to elective deferrals under a section 401(k) plan, section 403(b) annuity, or certain similar arrangements, (2) made to an individual who (by reason of being a member of a reserve component as defined in section 101 of title 37 of the U.S. Code) was ordered or called to active duty for a period in excess of 179 days or for an indefinite period, and (3) that is made during the period beginning on the date of such order or call to duty and ending at the close of the active duty period. A section 401(k) plan or section 403(b) annuity does not violate the distribution restrictions applicable to such plans by reason of making a qualified reservist distribution.

An individual who receives a qualified reservist distribution may, at any time during the two-year period beginning on the day after the end of the active duty period, make one or more contributions to an IRA of such individual in an aggregate amount not to exceed the amount of such distribution. The dollar limitations otherwise applicable to contributions to IRAs do not apply to any contribution made pursuant to this special repayment rule. No deduction is allowed for any contribution made under the special repayment rule.

The special rules applicable to a qualified reservist distribution apply to individuals ordered or called to active duty after September 11, 2001, and before December 31, 2007.

[29] Pub. L. No. 109-280.

Reasons for Change

The Committee believes that the exception to the 10-percent early withdrawal tax is an important tax relief provision for reservists called to active duty. Reservists called to active duty may need access to amounts that they have contributed to tax-favored retirement savings programs in order to meet their personal financial obligations while serving our country. Given the continuing need for activation of reservists, the Committee believes that this tax relief provision should be extended so that it applies to reservists called to active duty on or after December 31, 2007.

Explanation of Provision

The provision extends the rules applicable to qualified reservist distributions to individuals ordered or called to active duty before January 1, 2009.

Effective Date

The provision is effective upon enactment.

11. Extension of special rule for regulated investment company stock held in the estate of a nonresident non-citizen (sec. 311 of the bill and sec. 2105(d) of the Code)

Present Law

The gross estate of a decedent who was a U.S. citizen or resident generally includes all property -- real, personal, tangible, and intangible -- wherever situated.[30] The gross estate of a nonresident non-citizen decedent, by contrast, generally includes only property that at the time of the decedent's death is situated within the United States.[31] Property within the United States generally includes debt obligations of U.S. persons, including the Federal government and State and local governments, but does not include either bank deposits or portfolio obligations the interest on which would be exempt from U.S. income tax under section 871.[32] Stock owned and held by a nonresident non-citizen generally is treated as property within the United States if the stock was issued by a domestic corporation.[33]

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[30] Sec. 2031. The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") repealed the estate tax for estates of decedents dying after December 31, 2009. EGTRRA, however, included a termination provision under which EGTRRA's rules, including estate tax repeal, do not apply to estates of decedents dying after December 31, 2010.

[31] Sec. 2103.

[32] Secs. 2104(c), 2105(b).

[33] Sec. 2104(a); Treas. Reg. sec. 20.2104-1(a)(5)).

Treaties may reduce U.S. taxation of transfers of the estates of nonresident non-citizens. Under recent treaties, for example, U.S. tax generally may be eliminated except insofar as the property transferred includes U.S. real property or business property of a U.S. permanent establishment.

Although stock issued by a domestic corporation generally is treated as property within the United States, stock of a regulated investment company ("RIC") that was owned by a nonresident non-citizen is not deemed property within the United States in the proportion that, at the end of the quarter of the RIC's taxable year immediately before a decedent's date of death, the assets held by the RIC are debt obligations, deposits, or other property that would be treated as situated outside the United States if held directly by the estate (the "estate tax look-through rule for RIC stock").[34] This estate tax look-through rule for RIC stock does not apply to estates of decedents dying after December 31, 2007.

Reasons for Change

If a RIC satisfies certain income, asset, and distribution requirements, only one level of income tax generally is imposed on the income and gains of a RIC, and this tax is imposed on the RIC stockholders. By extension, the Committee believes it is appropriate to treat a RIC as a conduit under the rules for determining the extent to which the transfer of the estate of a nonresident non-citizen is subject to U.S. Federal estate tax. To the extent the assets of a RIC would not be subject to U.S. estate tax if held directly by an estate, the Committee believes there should be no estate tax when the assets are owned indirectly by ownership of stock in a RIC.

Explanation of Provision

The provision permits the estate tax look-through rule for RIC stock to apply to estates of decedents dying before January 1, 2009.

Effective Date

The provision applies to estates of decedents dying after December 31, 2007.

12. Extend RIC "qualified investment entity" treatment under FIRPTA (sec. 312 of the bill and sec. 897(h) of the Code).

Present law

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or effectively connected business requirements are met. However, under the Foreign Investment in Real Property Tax Act ("FIRPTA") provisions codified in section 897 of the Code, a foreign person who sells a U.S. real property interest (USRPI) is

[34] Sec. 2105(d).

treated as if the gain from such a sale is effectively connected with a U.S. business, and is subject to tax at the same rates as a U.S. person. Withholding tax is also imposed under section 1445.

A USPRI, the sale of which is subject to FIRPTA tax, includes stock or a beneficial interest in any U.S. real property holding corporation (as defined), unless the stock is regularly traded on an established securities market and the selling foreign corporation or nonresident alien individual held no more than 5 percent of that stock within the 5-year period ending on date of disposition (or, if shorter, during the period in which the entity was in existence). There is an exception, however, for stock of a domestically controlled "qualified investment entity." However, if stock of a domestically controlled qualified investment entity is disposed of within the 30 days preceding a dividend distribution in an "applicable wash sale transaction," in which an amount that would have been a taxable distribution (as described below) is instead treated as nontaxable sales proceeds, but substantially similar stock is reacquired (or an option to obtain it is acquired) within a 61 day period, then the amount that would have been a taxable distribution continues to be taxed.

A distribution from a "qualified investment entity" that is attributable to the sale of a USRPI is subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United Sates and the recipient foreign corporation or nonresident alien individual held no more than 5 percent of that class of stock or beneficial interest within the 1-year period ending on the date of distribution. Special rules apply to situations involving tiers of qualified investment entities.

The term "qualified investment entity" includes a regulated investment company ("RIC") that meets certain requirements, although the inclusion of a RIC in that definition is scheduled to expire, for certain purposes, on December 31, 2007.[35] The definition does not expire for purposes of taxing distributions from the RIC that are attributable directly or indirectly to a distribution to the entity from a real estate investment trust, nor for purposes of the applicable wash sale rules.

Reasons for Change

The committee believes it is desirable to extend the present law provision for an additional year.

Explanation of Provision

The proposal would extend the inclusion of a regulated investment company (RIC) within the definition of a "qualified investment entity" under section 897 of the Code through December 31, 2008, for those situations in which that that inclusion would otherwise expire at the end of 2007.

[35] Section 897(h)

Effective Date

The proposal would take effect on January 1, 2008.

13. State legislators' travel expenses away from home (sec. 313 of the bill and sec. 162 of the Code)

Present Law

In general, for Federal income tax purposes, any individual who is a State legislator, at any time during the year, may elect to deduct deemed living expenses while away from home as a miscellaneous itemized deduction.[36] If such election is made, the State legislator's place of residence within the legislative district is considered his home. A State legislator is deemed to incur for living expenses an amount equal to the product of the State legislator's legislative days and the per diem amount.

The State legislator's legislative days is the number of days the legislature was in session (including any day not in session for a period of four consecutive days or less),[37] plus any day the physical presence of the individual was recorded at a committee meeting.[38]

The per diem amount is the greater of: (1) the per diem amount allowable to employees of the State, for which he or she is a legislator, while away from home, not to exceed 110 percent of the Federal government amount,[39] or (2) the amount allowable to executive branch employees of the Federal government for per diem while away from home.[40]

The election is not available if the legislator's place of residence within the legislative district is within 50 miles of the State Capitol.[41]

Reasons for Change

The Committee believes that the definition of what constitutes a legislative day should be clarified. The Committee is aware that the IRS and Treasury are working on authoritative guidance on the issue. However, in the absence of such guidance, the Committee believes that a temporary statutory rule is necessary so that taxpayers are provided certainty in their positions.

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[36] Sec. 162(h).

[37] Sec. 162(h)(2)(A).

[38] Sec. 162(h)(2)(B).

[39] Sec. 162(h)(1)(B)(i).

[40] Sec. 162(h)(1)(B)(ii).

[41] Sec. 162(h)(4).

It is intended that the Committee will revisit the appropriateness of the provision after a thorough study of the issue.

Explanation of Provision

The provision clarifies the definition of legislative days to include any day in which the legislature is formally called into session without regard to whether legislation was considered on such day. The provision applies in the case of the taxpayer's taxable year beginning in 2008.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

B. Extenders Primarily Affecting Businesses

1. Extend the research and experimentation tax credit (sec. 321 of the bill and sec. 41 of the Code)

Present Law

General rule

A taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.[42] Thus, the research credit is generally available with respect to incremental increases in qualified research.

A 20-percent research tax credit is also available with respect to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the university basic research credit.[43]

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium. This separate credit computation is commonly referred to as the energy research credit. Unlike the other research credits, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit, including the university basic research credit and the energy research credit, is scheduled to expire and generally will not apply to amounts paid or incurred after December 31, 2007.[44]

Computation of allowable credit

Except for energy research payments and certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's fixed-base

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[42] Sec. 41.

[43] Sec. 41(e).

[44] The research tax credit was initially enacted in the Economic Recovery Tax Act of 1981. It has been subsequently extended and modified numerous times. Most recently, the Tax Relief and Health Care Act of 2006 extended the research credit through December 31, 2007, modified the alternative incremental research credit, and added an election to claim an alternative simplified credit.

percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). All other taxpayers (so-called start-up firms) are assigned a fixed-base percentage of three percent.[45]

In computing the credit, a taxpayer's base amount can not be less than 50 percent of its current-year qualified research expenses.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, a special aggregation rule provides that all members of the same controlled group of corporations are treated as a single taxpayer.[46] Under regulations prescribed by the Secretary, special rules apply for computing the credit when a major portion of a trade or business (or unit thereof) changes hands, under which qualified research expenses and gross receipts for periods prior to the change of ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenses and receipts for purposes of recomputing a taxpayer's fixed-base percentage.[47]

Alternative incremental research credit regime

Taxpayers are allowed to elect an alternative incremental research credit regime.[48] If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced.

Generally, for amounts paid or incurred prior to 2007, under the alternative incremental credit regime, a credit rate of 2.65 percent applies to the extent that a taxpayer's current-year

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[45] The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).

[46] Sec. 41(f)(1).

[47] Sec. 41(f)(3).

[48] Sec. 41(c)(4).

research expenses exceed a base amount computed by using a fixed-base percentage of one percent (i.e., the base amount equals one percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 3.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of two percent. A credit rate of 3.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of two percent. Generally, for amounts paid or incurred after 2006, the credit rates listed above are increased to three percent, four percent, and five percent, respectively.[49]

An election to be subject to this alternative incremental credit regime can be made for any taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years unless revoked with the consent of the Secretary of the Treasury.

Alternative simplified credit

Generally, for amounts paid or incurred after 2006, taxpayers may elect to claim an alternative simplified credit for qualified research expenses.[50] The alternative simplified research credit is equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to six percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.

An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary. An election to use the alternative simplified credit may not be made for any taxable year for which an election to use the alternative incremental credit is in effect. A transition rule applies which permits a taxpayer to elect to use the alternative simplified credit in lieu of the alternative incremental credit if such election is made during the taxable year which includes January 1, 2007. The transition rule applies only to the taxable year which includes that date.

Eligible expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called contract research expenses).[51] Notwithstanding the limitation for

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[49] A special transition rule applies for fiscal year 2006-2007 taxpayers.

[50] A special transition rule applies for fiscal year 2006-2007 taxpayers.

[51] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research

contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or Federal laboratory for qualified energy research.

To be eligible for the credit, the research does not only have to satisfy the requirements of present-law section 174 (described below) but also must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors.[52] In addition, research does not qualify for the credit: (1) if conducted after the beginning of commercial production of the business component; (2) if related to the adaptation of an existing business component to a particular customer's requirements; (3) if related to the duplication of an existing business component from a physical examination of the component itself or certain other information; or (4) if related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control.[53] Research does not qualify for the credit if it is conducted outside the United States, Puerto Rico, or any U.S. possession.

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures paid or incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized.[54] However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.[55] Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.[56]

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consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. Sec. 41(b)(3)(C).

[52] Sec. 41(d)(3).

[53] Sec. 41(d)(4).

[54] Taxpayers may elect 10-year amortization of certain research expenditures allowable as a deduction under section 174(a). Secs. 174(f)(2) and 59(e).

[55] Sec. 280C(c).

[56] Sec. 280C(c)(3).

Reasons for Change

The Committee acknowledges that research is important to the economy. Research is the basis of new products, new services, new industries, and new jobs for the domestic economy. Therefore the Committee believes it is appropriate to extend the present-law research credit.

Explanation of Provision

The provision extends the research credit for one year.

Effective Date

The provision is effective for amounts paid or incurred after December 31, 2007.

2. Indian employment tax credit (sec. 322 of the bill and sec. 45A of the Code)

Present Law

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees (sec. 45A). The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An "Indian reservation" is a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(1) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (which after adjustment for inflation is currently $40,000).[57] In addition, an employee will not be treated as a

[57] See Form 8845, Indian Employment Credit (Rev. December 2006).

qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a 5 percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee's services relate to gaming activities or are performed in a building housing such activities.

The wage credit is available for wages paid or incurred on or after January 1, 1994, in taxable years that begin before January 1, 2007.

Reasons for Change

To further encourage employment on Indian reservations, the Committee believes it is appropriate to extend the Indian employment credit an additional year.

Explanation of Provision

The provision extends for one year the present-law employment credit provision (through taxable years beginning on or before December 31, 2008).

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

3. Extend the new markets tax credit (sec. 323 of the bill and sec. 45D of the Code)

Present Law

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[58] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years. The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available for a taxable year to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year. The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity ceases to be a qualified CDE, the proceeds of the investment cease to be used as required, or the equity investment is redeemed.

[58] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554 (December 21, 2000).

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE. A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder. Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (rather than 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary has the authority to designate "targeted populations" as low-income communities for purposes of the new markets tax credit. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4702(20)) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate access to loans or equity investments. Under such Act, "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide non-metropolitan area median family income.[59] Under such Act, a targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

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[59] 12 U.S.C. 4702(17) (defines "low-income" for purposes of 12 U.S.C. 4702(20)).

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of such business is used in a low-income community; (3) a substantial portion of the services performed for such business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of such business is attributable to certain financial property or to certain collectibles.

The maximum annual amount of qualified equity investments is capped at $2.0 billion per year for calendar years 2004 and 2005, and at $3.5 billion per year for calendar years 2006, 2007, and 2008.

Reasons for Change

The Committee believes that the new markets tax credit has proved to be an effective means of providing equity and other investments to benefit businesses in low income communities, and that it is appropriate to provide for the allocation of additional investments for another calendar year.

Explanation of Provision

The provision extends the new markets tax credit for one year, through 2009, permitting up to $3.5 billion in qualified equity investments for that calendar year. The Committee is concerned that the Treasury Department has not exercised its authority under section 45D(e)(2) to prescribe regulations with regard to the definition of "targeted populations." The Committee urges the Treasury department to do so in a timely manner. Should the Treasury Department continue to delay prescription of such regulations, the Committee may take legislative action with regard to that definition.

Effective Date

The provision is effective on the date of enactment.

4. Extend railroad track maintenance credit (sec. 324 of the bill and sec. 45G of the Code)

Present Law

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during the taxable year.[60] The credit is limited to the product of $3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year, and (2) assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the

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[60] Sec. 45G(a).

taxable year.[61] Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. Under the provision, the credit is limited in respect of the total number of miles of track (1) owned or leased by the Class II or Class III railroad and (2) assigned to the Class II or Class III railroad for purposes of the credit.

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).[62]

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only with respect to miles of railroad track assigned to such person by such railroad under the provision.[63]

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.[64]

The provision applies to qualified railroad track maintenance expenditures paid or incurred during taxable years beginning after December 31, 2004, and before January 1, 2008.

Reasons for Change

The Committee believes that Class II and Class III railroads are an important part of the nation's railway system. Therefore, the Committee believes that this incentive for railroad track maintenance expenditures should be extended.

Explanation of Provision

The provision extends the present law provision for one year, for qualified railroad track maintenance expenditures paid or incurred before January 1, 2009.

Effective Date

The provision is effective for expenditures paid or incurred after December 31, 2007.

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[61] Sec. 45G(b)(1).

[62] Sec. 45G(d).

[63] Sec. 45G(c).

[64] Sec. 45G(e)(1).

5. Fifteen-year straight-line cost recovery for qualified leasehold improvements and qualified restaurant improvements (sec. 325 of the bill and sec. 168 of the Code)

Present Law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[65] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements and certain qualified restaurant property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2008. Qualified leasehold improvement property is recovered using the straight-line method. Leasehold improvements placed in service in 2008 and later will be subject to the general rules described above.

Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was

[65] Sec. 168.

first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.

If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2008. For purposes of the provision, qualified restaurant property means any improvement to a building if such improvement is placed in service more than three years after the date such building was first placed in service and more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals. Qualified restaurant property is recovered using the straight-line method.

Reasons for Change

The Committee believes that it is appropriate to extend the 15-year recovery period for qualified leasehold improvements and qualified restaurant property.

Explanation of Provision

The present-law provisions for qualified leasehold improvement property and qualified restaurant property are extended for one year (through December 31, 2008).

Effective Date

The provision applies to property placed in service after December 31, 2007.

6. 7-year recovery period for motorsports racetrack property (sec. 326 of the bill and sec. 168 of the Code)

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[66] The cost of nonresidential real property is recovered using the straight-line method

[66] Sec. 168.

of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month. Land improvements (such as roads and fences) are recovered over 15 years. An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years. Additionally, a motorsports entertainment complex placed in service before December 31, 2007 is assigned a recovery period of seven years.[67] For these purposes, a motorsports entertainment complex means a racing track facility which is permanently situated on land that during the 36 month period following its placed in service date it hosts a racing event.[68] The term motorsports entertainment complex also includes ancillary facilities, land improvements (e.g., parking lots, sidewalks, fences), support facilities (e.g., food and beverage retailing, souvenir vending), and appurtenances associated with such facilities (e.g., ticket booths, grandstands).

Reasons for Change

The Committee believes that extending the depreciation incentive will encourage economic development. Therefore, the provision extends the 7-year recovery period for motorsports entertainment complex property.

Explanation of Provision

The provision extends the present law seven year recovery period for one year (through December 31, 2008).

Effective Date

The provision is effective for property placed in service after December 31, 2007.

7. Accelerated depreciation for business property on Indian reservations (sec. 327 of the bill and sec. 168 of the Code)

Present Law

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j) are determined using the following recovery periods:

3-year property	2 years
5-year property	3 years

[67] Sec. 168(e)(3)(C)(ii).

[68] Sec. 168(i)(15).

7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Nonresidential real property	22 years

"Qualified Indian reservation property" eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer;[69] and (4) is not property placed in service for purposes of conducting gaming activities.[70] Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).[71]

An "Indian reservation" means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(10) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for Indian reservations is available with respect to property placed in service on or after January 1, 1994, and before January 1, 2008.

Reasons for Change

The Committee believes that extending the depreciation incentive will encourage economic development within Indian reservations and expand employment opportunities on such reservations.

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[69] For these purposes, related persons is defined in Sec. 465(b)(3)(C).

[70] Sec. 168(j)(4)(A).

[71] Sec. 168(j)(4)(C).

Explanation of Provision

The provision extends for one year the present-law incentive relating to depreciation of qualified Indian reservation property (to apply to property placed in service through December 31, 2008).

Effective Date

The provision applies to property placed in service after December 31, 2007.

8. Extend expensing of brownfields remediation costs (sec. 328 of the bill and sec. 198 of the Code)

Present Law

Present law allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[72] Treasury regulations provide that the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury regulations define "capital expenditures" as amounts paid or incurred to materially add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use. Amounts paid for repairs and maintenance do not constitute capital expenditures. The determination of whether an expense is deductible or capitalizable is based on the facts and circumstances of each case.

Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred.[73] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which would otherwise be allocated to the site under the principles set forth in Commissioner v. Idaho Power Co.[74] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" (a so-called "brownfield") generally is any property that is held for use in a trade or business, for the production of income, or as inventory and is certified by the appropriate State environmental agency to be an area at or on which there has

[72] Sec. 162.

[73] Sec. 198.

[74] 418 U.S. 1 (1974).

been a release (or threat of release) or disposal of a hazardous substance. Both urban and rural property may qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA")[75] cannot qualify as targeted areas. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use, as well as petroleum products defined in section 4612(a)(3) of the Code.

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures are subject to recapture as ordinary income upon a sale or other disposition of the property. In addition, sections 280B (demolition of structures) and 468 (special rules for mining and solid waste reclamation and closing costs) do not apply to amounts that are treated as expenses under this provision.

Eligible expenditures are those paid or incurred before January 1, 2008.

The Gulf Opportunity Zone Act of 2005[76] added section 1400N(g) to the Code, which extended for two years (through December 31, 2007) the expensing of environmental remediation expenditures paid or incurred to abate contamination at qualified contaminated sites located in the Gulf Opportunity Zone. As a result of the extension of section 198 contained in the Tax Relief and Health Care Act of 2006,[77] eligible expenditures covered under both section 1400N(g) and section 198 must be paid or incurred prior to January 1, 2008.

Reasons for Change

The Committee believes that the expensing of brownfields remediation costs promotes the goal of environmental remediation and promotes new investment and employment opportunities by lowering the net capital cost of a development project. Therefore, the Committee believes it is appropriate to extend the present-law provision permitting the expensing of these environmental remediation costs.

Explanation of Provision

The provision extends the present law expensing provision under section 198 for one year through December 31, 2008.

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[75] Pub. L. No. 96-510 (1980).

[76] Pub. L. No. 109-135 (2005).

[77] Pub. L. No. 109-432 (2006).

Effective Date

The provision is effective for expenditures paid or incurred after December 31, 2007.

9. Extension of deduction for income attributable to domestic production activities in Puerto Rico (sec. 329 of the bill and sec. 199 of the Code)

Present Law

In general

Present law provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to a portion of the taxpayer's qualified production activities income. For taxable years beginning after 2009, the deduction is nine percent of that income. For taxable years beginning in 2005 and 2006, the deduction is three percent of qualified production activities income and for taxable years beginning in 2007, 2008, and 2009, the deduction is six percent of qualified production activities income. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to just under 32 percent on qualified production activities income.

Qualified production activities income

In general, qualified production activities income is equal to domestic production gross receipts (defined by section 199(c)(4)), reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[78] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[79] produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or

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[78] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[79] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

(5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

Wage limitation

For taxable years beginning after May 17, 2006, the amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[80] Wages paid to bona fide residents of Puerto Rico generally are not included in the wage limitation amount.[81]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia.[82] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's gross receipts are taxable under the Federal income tax for individuals or corporations.[83] In computing the 50-percent wage limitation, that taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[84]

The special rules for Puerto Rico apply only with respect to the first two taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2008.

Reasons for Change

The Committee believes that given the expiration of the Puerto Rico economic activity credit after 2005, it is appropriate to use other means to encourage investment in Puerto Rico. In particular, the Committee believes it is appropriate to treat a U.S. taxpayer's manufacturing

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[80] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. For taxable years beginning before May 18, 2006, the limitation is based upon all wages paid by the taxpayer, rather than only wages properly allocable to domestic production gross receipts.

[81] Sec. 3401(a)(8)(C).

[82] Sec. 7701(a)(9).

[83] Sec. 199(d)(8)(A).

[84] Sec. 199(d)(8)(B).

activities in Puerto Rico in a manner similar to the treatment of manufacturing activities in the United States.

Explanation of Provision

The provision allows the special domestic production activities rules for Puerto Rico to apply for one additional taxable year of a taxpayer.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

10. Modify tax treatment of certain payments to controlling exempt organizations (sec. 330 of the bill and sec. 512 of the Code)

Present Law

In general, organizations exempt from Federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[85] In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.[86]

Section 512(b)(13) provides special rules regarding income derived by an exempt organization from a controlled subsidiary. In general, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt). However, a special rule enacted as part of the Pension Protection Act of 2006 provides that, for payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of section 512(b)(13) applies only to the portion of payments received or accrued (before January 1, 2008) in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of section 482 (i.e., at arm's length).[87] In addition, the special rule imposes a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

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[85] Sec. 511.

[86] Sec. 512(b).

[87] Sec. 512(b)(13)(E).

In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, "control" means ownership of more than 50 percent of the profits, capital, or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

Reasons for Change

In enacting the special rule described above, the Pension Protection Act also required that, not later than January 1, 2009, the Secretary shall submit a report to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives a report on the effectiveness of the Internal Revenue Service in administering the special rule and on the extent to which payments by controlled entities to the controlling exempt organization meet the requirements of section 482 of the Code. Such report is required to include the results of any audit of any controlling organization or controlled entity and recommendations relating to the tax treatment of payments from controlled entities to controlling organizations. Considering that the report is not due until January 1, 2009, the Committee believes it is appropriate to extend the special rule for one year.

Explanation of Provision

The provision extends the special rule of the Pension Protection Act to payments received or accrued before January 1, 2009. Accordingly, under the provision, payments of rent, royalties, annuities, or interest income by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of section 482 (i.e., at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

Effective Date

The provision is effective for payments received or accrued after December 31, 2007.

11. Extend and modify qualified zone academy bonds (sec. 331 of the bill and sec. 1397E of the Code)

Present Law

Tax-exempt bonds

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. Activities that can be financed with these tax-exempt bonds include the financing of public schools.[88] An issuer must file with the IRS certain information about the bonds issued by them in order for that bond issue to be tax-exempt.[89] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[90] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[91] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue "qualified zone academy bonds".[92] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2007. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond was 50 percent of the face value of the bond.

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[88] Sec. 103.

[89] Sec. 149(e).

[90] Sec. 103(a) and (b)(2).

[91] Sec. 148.

[92] Sec. 1397E.

"Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

The Tax Relief and Health Care Act of 2006 ("TRHCA")[93] imposed the arbitrage requirements that generally apply to interest-bearing tax-exempt bonds to qualified zone academy bonds. In addition, an issuer of qualified zone academy bonds must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified zone academy property within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified zone academy property during the five-year spending period, bonds will continue to qualify as qualified zone academy bonds if unspent proceeds are used within 90 days from the end of such five-year period to redeem any nonqualified bonds. The five-year spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable cause and the related purposes for issuing the bonds will continue to proceed with due diligence. Issuers of qualified zone academy bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

Reasons for Change

The Committee believes that tax-credit bonds provide an effective means of subsidizing rehabilitation and repairs to public school facilities. Thus, the Committee believes that the extension of authority to issue qualified zone academy bonds is appropriate in light of the educational needs that exist today. However, the Committee also recognizes that modifications to the present law qualified zone academy bond program may be necessary to increase the marketability of such bonds. These modifications also will promote additional investment in the beneficiary public schools.

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[93] Pub. L. 109-432.

Explanation of Provision

The provision authorizes issuance of up to $400 million of qualified zone academy bonds annually through 2008.

The provision also modifies the spending and arbitrage rules that apply to qualified zone academy bonds. The provision modifies the spending rule by requiring 95 percent of available project proceeds to be spent on qualified zone academy property. In addition, the provision modifies the arbitrage rules by providing that available project proceeds invested during the five-year period beginning on the date of issue are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). The provision defines "available project proceeds" as proceeds from the sale of an issue of qualified zone academy bonds, less issuance costs (not to exceed two percent) and any investment earnings on such proceeds. Thus, available project proceeds invested during the five-year spending period may be invested at unrestricted yields, but the earnings on such investments must be spent on qualified zone academy property.

The provision also provides that amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner such that the fund will not exceed the amount necessary to repay the issue if invested at the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified zone academy bonds are issued; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified zone academy bonds are issued.

Effective Date

The provision to extend authority to issue qualified zone academy bonds through 2008 applies to bonds issued after December 31, 2007. The provision to modify the spending and arbitrage rules applies to bonds issued after the date of enactment.

12. Tax incentives for investment in the District of Columbia (sec. 332 of the bill and secs. 1400, 1400A, 1400B, and 1400C of the Code)

Present Law

In general

The Taxpayer Relief Act of 1997 designated certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone (the "D.C. Zone"), within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Zone are (1) all census tracts that presently are part of the D.C. enterprise community designated under section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District), and (2) all additional census tracts within the District of Columbia where the poverty rate is not less than 20 percent. The D.C. Zone designation remains in effect for the period from January 1, 1998, through December 31, 2007. In general, the tax incentives available in connection with the D.C. Zone are a 20-percent wage credit, an additional $35,000 of section 179 expensing for qualified zone property, expanded tax-exempt financing for certain zone facilities, and a zero-percent capital gains rate from the sale of certain qualified D.C. zone assets.

Wage credit

A 20-percent wage credit is available to employers for the first $15,000 of qualified wages paid to each employee (i.e., a maximum credit of $3,000 with respect to each qualified employee) who (1) is a resident of the D.C. Zone, and (2) performs substantially all employment services within the D.C. Zone in a trade or business of the employer.

Wages paid to a qualified employee who earns more than $15,000 are eligible for the wage credit (although only the first $15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the D.C. Zone may claim the wage credit, regardless of whether the employer meets the definition of a "D.C. Zone business."[94]

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[95] Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under section 51 or the welfare-to-work credit under section 51A.[96] In addition, the $15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.[97] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[98]

Section 179 expensing

In general, a D.C. Zone business is allowed an additional $35,000 of section 179 expensing for qualifying property placed in service by a D.C. Zone business.[99] The section 179

[94] However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B) or certain farming activities. In addition, wages are not eligible for the wage credit if paid to (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

[95] Sec. 280C(a).

[96] Secs. 1400H(a), 1396(c)(3)(A) and 51A(d)(2).

[97] Secs. 1400H(a), 1396(c)(3)(B) and 51A(d)(2).

[98] Sec. 38(c)(2).

[99] Sec. 1397A.

expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds $200,000 ($500,000 for taxable years beginning after 2006 and before 2011). The term "qualified zone property" is defined as depreciable tangible property (including buildings), provided that (1) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (2) the original use of the property in the D.C. Zone commences with the taxpayer, and (3) substantially all of the use of the property is in the D.C. Zone in the active conduct of a trade or business by the taxpayer.[100] Special rules are provided in the case of property that is substantially renovated by the taxpayer.

Tax-exempt financing

A qualified D.C. Zone business is permitted to borrow proceeds from tax-exempt qualified enterprise zone facility bonds (as defined in section 1394) issued by the District of Columbia.[101] Such bonds are subject to the District of Columbia's annual private activity bond volume limitation. Generally, qualified enterprise zone facility bonds for the District of Columbia are bonds 95 percent or more of the net proceeds of which are used to finance certain facilities within the D.C. Zone. The aggregate face amount of all outstanding qualified enterprise zone facility bonds per qualified D.C. Zone business may not exceed $15 million and may be issued only while the D.C. Zone designation is in effect.

Zero-percent capital gains

A zero-percent capital gains rate applies to capital gains from the sale of certain qualified D.C. Zone assets held for more than five years.[102] In general, a qualified "D.C. Zone asset" means stock or partnership interests held in, or tangible property held by, a D.C. Zone business. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent.

In general, gain eligible for the zero-percent tax rate means gain from the sale or exchange of a qualified D.C. Zone asset that is (1) a capital asset or property used in the trade or business as defined in section 1231(b), and (2) acquired before January 1, 2008. Gain that is attributable to real property, or to intangible assets, qualifies for the zero-percent rate, provided that such real property or intangible asset is an integral part of a qualified D.C. Zone business.[103]

[100] Sec. 1397D.

[101] Sec. 1400A.

[102] Sec. 1400B.

[103] However, sole proprietorships and other taxpayers selling assets directly cannot claim the zero-percent rate on capital gain from the sale of any intangible property (i.e., the integrally related test does not apply).

However, no gain attributable to periods before January 1, 1998, and after December 31, 2012, is qualified capital gain.

<u>District of Columbia homebuyer tax credit</u>

First-time homebuyers of a principal residence in the District of Columbia are eligible for a nonrefundable tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000-$130,000 for joint filers). For purposes of eligibility, "first-time homebuyer" means any individual if such individual did not have a present ownership interest in a principal residence in the District of Columbia in the one-year period ending on the date of the purchase of the residence to which the credit applies. The credit expires for purchases after December 31, 2007.[104]

Reasons for Change

The Committee believes that it continues to be important to provide tax incentives to individuals and businesses in the D.C. Zone and that it is appropriate to extend such incentives for an additional year.

Explanation of Provision

The provision extends the designation of the D.C. Zone for one year (through December 31, 2008), thus extending the wage credit and section 179 expensing for one year.

The provision extends the tax-exempt financing authority for one year, applying to bonds issued during the period beginning on January 1, 1998, and ending on December 31, 2008.

The provision extends the zero-percent capital gains rate applicable to capital gains from the sale of certain qualified D.C. Zone assets for one year.

The provision extends the first-time homebuyer credit for one year, through December 31, 2008.

Effective Date

The provision is effective for periods beginning after, bonds issued after, acquisitions after, and property purchased after December 31, 2007.

[104] Sec. 1400C(i).

13. Extension of economic development credit for American Samoa (sec. 333 of the bill and sec. 119 of Pub. L. No. 109-432)

Present and Prior Law

In general

For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit.[105] This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions.[106] For purposes of the credit, possessions included, among other places, American Samoa. Subject to certain limitations described below, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment.[107] No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936.[108] The section 936 credit generally expired for taxable years beginning after December 31, 2005, but a special credit, described below, was allowed with respect to American Samoa.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business.

The possession tax credit was available only to a corporation that qualified as an existing credit claimant. The determination of whether a corporation was an existing credit claimant was made separately for each possession. The possession tax credit was computed separately for each possession with respect to which the corporation was an existing credit claimant, and the credit was subject to either an economic activity-based limitation or an income-based limitation.

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[105] Secs. 27(b), 936.

[106] Domestic corporations with activities in Puerto Rico are eligible for the section 30A economic activity credit. That credit is calculated under the rules set forth in section 936.

[107] Under phase-out rules described below, investment only in Guam, American Samoa, and the Northern Mariana Islands (and not in other possessions) now may give rise to income eligible for the section 936 credit.

[108] Sec. 936(c).

Qualification as existing credit claimant

A corporation was an existing credit claimant with respect to a possession if (1) the corporation was engaged in the active conduct of a trade or business within the possession on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit in an election in effect for its taxable year that included October 13, 1995.[109] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

Economic activity-based limit

Under the economic activity-based limit, the amount of the credit determined under the rules described above was not permitted to exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes.

Income-based limit

As an alternative to the economic activity-based limit, a taxpayer was permitted elect to apply a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income; in taxable years beginning in 1998 and subsequent years, the applicable percentage was 40 percent.

Repeal and phase out

In 1996, the section 936 credit was repealed for new claimants for taxable years beginning after 1995 and was phased out for existing credit claimants over a period including taxable years beginning before 2006. The amount of the available credit during the phase-out period generally was reduced by special limitation rules. These phase-out period limitation rules did not apply to the credit available to existing credit claimants for income from activities in Guam, American Samoa, and the Northern Mariana Islands. As described previously, the section 936 credit generally was repealed for all possessions, including Guam, American Samoa, and the Northern Mariana Islands, for all taxable years beginning after 2005, but a modified credit was allowed for activities in American Samoa.

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[109] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

American Samoa economic development credit

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006 is allowed a credit based on the economic activity-based limitation rules described above. The credit is not part of the Code but is computed based on the rules secs. 30A and 936. The credit is allowed for the first two taxable years of a corporation that first two taxable years of a corporation that begin after December 31, 2005, and before January 1, 2008.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation (described previously) with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

The credit is not available for taxable years beginning after December 31, 2007.

Reasons for Change

The Committee believes that it is important to encourage investment in American Samoa. With the expiration of the possession tax credit, the American Samoa economic development credit is an appropriate temporary provision while Congress considers long-term tax policy toward the U.S. possessions.

Explanation of Provision

The provision allows the American Samoa economic development credit for one additional taxable year of a taxpayer.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

14. Extend the enhanced charitable deduction for contributions of food inventory (sec. 334 of the bill and sec. 170 of the Code)

Present Law

General rules regarding contributions of food inventory

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less the fair market value of the inventory.

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[110] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[111] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[112] Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor other than as a charitable contribution.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.[113]

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[110] Sec. 170(e)(3).

[111] Sec. 170(b)(2).

[112] Treas. Reg. sec. 1.170A-4A(c)(3).

[113] *Lucky Stores Inc. v. Commissioner,* 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).

<u>Temporary rule expanding and modifying the enhanced deduction for contributions of food inventory</u>

Under a temporary provision enacted as part of the Katrina Emergency Tax Relief Act of 2005 and extended by the Pension Protection Act of 2006, any taxpayer, whether or not a C corporation, engaged in a trade or business is eligible to claim the enhanced deduction for donations of food inventory.[114] For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporation) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.[115]

Under the temporary provision, the enhanced deduction for food is available only for food that qualifies as "apparently wholesome food." "Apparently wholesome food" is defined as food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

The temporary provision does not apply to contributions made after December 31, 2007.

<u>Reasons for Change</u>

The Committee believes that charitable organizations benefit from charitable contributions of food by non C corporations and that the enhanced deduction is a useful incentive for the making of such contributions. Accordingly, the Committee believes it is appropriate to extend the special rule for charitable contributions of food inventory for one year.

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[114] Sec. 170(e)(3)(C).

[115] The 10 percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory by a taxpayer that is not a C corporation that exceed the 10 percent limitation but not the 50 percent limitation could not be carried forward.

Explanation of Provision

The provision extends the expansion of, and modifications to, the enhanced deduction for charitable contributions of food inventory to contributions made before January 1, 2009.

Effective Date

The provision is effective for contributions made after December 31, 2007.

15. Extend the enhanced deduction for charitable contributions of book inventory (sec. 335 of the bill and sec. 170 of the Code)

Present Law

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or, if less, the fair market value of the inventory.

In general, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[116] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[117] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[118] Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor other than as a charitable contribution.

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[116] Sec. 170(e)(3).

[117] Sec. 170(b)(2).

[118] Treas. Reg. sec. 1.170A-4A(c)(3).

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

The Katrina Emergency Tax Relief Act of 2005 expanded the generally applicable enhanced deduction for C corporations to certain qualified book contributions made after August 28, 2005, and before January 1, 2006. The Pension Protection Act of 2006 extended such deduction for qualified book contributions to contributions made before January 1, 2008. A qualified book contribution means a charitable contribution of books to a public school that provides elementary education or secondary education (kindergarten through grade 12) and that is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The enhanced deduction for qualified book contributions is not allowed unless the donee organization certifies in writing that the contributed books are suitable, in terms of currency, content, and quantity, for use in the donee's educational programs and that the donee will use the books in such educational programs. The donee also must make the certifications required for the generally applicable enhanced deduction, i.e., the donee will (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.

Reasons for Change

The Committee believes that public schools benefit from charitable contributions of book inventory and that the enhanced deduction is a useful incentive for the making of such contributions. Accordingly, the Committee believes it is appropriate to extend the enhanced deduction for charitable contributions of book inventory to public schools for one year.

Explanation of Provision

The provision extends the enhanced deduction for contributions of book inventory to contributions made before January 1, 2009.

Effective Date

The provision is effective for contributions made after December 31, 2007.

16. Extend the enhanced charitable deduction for computer technology and equipment (sec. 336 of the bill and sec. 170 of the Code)

Present Law

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the charitable deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.[119]

Under present law, a taxpayer's deduction for charitable contributions of computer technology and equipment generally is limited to the taxpayer's basis (typically, cost) in the property. However, certain corporations may claim a deduction in excess of basis for a "qualified computer contribution."[120] This enhanced deduction is equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis. The enhanced deduction for qualified computer contributions expires for any contribution made during any taxable year beginning after December 31, 2007.

A qualified computer contribution means a charitable contribution of any computer technology or equipment, which meets standards of functionality and suitability as established by the Secretary of the Treasury. The contribution must be to certain educational organizations or public libraries and made not later than three years after the taxpayer acquired the property or, if the taxpayer constructed or assembled the property, not later than the date construction or assembly of the property is substantially completed.[121] The original use of the property must be by the donor or the donee,[122] and in the case of the donee, must be used substantially for educational purposes related to the function or purpose of the donee. The property must fit productively into the donee's education plan. The donee may not transfer the property in exchange for money, other property, or services, except for shipping, installation, and transfer costs. To determine whether property is constructed or assembled by the taxpayer, the rules applicable to qualified research contributions apply. Contributions may be made to private foundations under certain conditions.[123]

Reasons for Change

The Committee believes that public libraries and educational organizations continue to benefit from corporate contributions of computer technology and equipment and that it is appropriate to extend the enhanced deduction for such contributions for one year.

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[119] Sec. 170(e)(1).

[120] Secs. 170(e)(4) and 170(e)(6).

[121] If the taxpayer constructed the property and reacquired such property, the contribution must be within three years of the date the original construction was substantially completed. Sec. 170(e)(6)(D)(i).

[122] This requirement does not apply if the property was reacquired by the manufacturer and contributed. Sec. 170(e)(6)(D)(ii).

[123] Sec. 170(e)(6)(C).

Explanation of Provision

The provision extends the enhanced deduction for computer technology and equipment for one year to apply to contributions made during any taxable year beginning after December 31, 2007, and before January 1, 2009.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

17. Basis adjustment to stock of S corporation contributing property (sec. 337 of the bill and secs. 1366 and 1367 of the Code)

Present Law

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.[124] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[125]

In the case of contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For contributions made in taxable years beginning after December 31, 2008, the reduction in basis is the fair market value of the contributed property.

Reasons for Change

The Committee believes that the present-law treatment of contributions of property by S corporations is appropriate and should be extended.

Explanation of Provision

The bill extends the rule relating to the basis reduction on account of charitable contributions of property for one year to contributions made in taxable years beginning before January 1, 2009.

The bill also makes a technical correction to the present-law rule limiting the amount of losses and deductions which a shareholder of an S corporation may take into account in any taxable year to the shareholder's adjusted basis in his stock and indebtedness of the corporation.

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[124] Sec. 1366(a)(1)(A).

[125] Sec. 1367(a)(2)(B).

The technical correction provides that this limitation does not apply to a contribution of appreciated property to the extent the shareholder's pro rata share of the contribution exceeds the shareholder's pro rata share of the adjusted basis of the property.

Effective Date

The provision extending the basis reduction rule applies to contributions made in taxable years beginning after December 31, 2007.

The technical correction is effective as if included in the legislation enacting the basis reduction rule which is being extended by the bill.

18. Extension of the Hurricane Katrina work opportunity tax credit (sec. 338 of the bill and sec. 51 of the Code)

Present Law

Work opportunity tax credit

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally an employer is eligible for the credit only for qualified wages paid to members of a targeted group. There are nine targeted groups: (1) families receiving Temporary Assistance for Needy Families Program ("TANF"); (2) qualified veterans; (3) qualified ex-felons; (4) designated community residents; (5) vocational rehabilitation referrals; (6) qualified summer youth employees; (7) qualified food stamp recipients; (8) qualified supplemental security income ("SSI") benefit recipients; and (9) qualified long-term family assistance recipients.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). There are two exceptions to this general rule. First, with respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Second, with respect to qualified veterans who are entitled to compensation for a service-connected disability, the maximum credit is $4,800 because qualified first-year wages are $12,000 rather than $6,000 for such individuals.[126] Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

Certification rules

An individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

[126] The expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food stamp program, as defined under present law.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after August 31, 2011.

Work Opportunity Tax Credit for Hurricane Katrina Employees

In general

The Katrina Emergency Tax Relief Act of 2005 provided that a Hurricane Katrina employee is treated as a member of a targeted group for purposes of the work opportunity tax credit. A Hurricane Katrina employee was: (1) an individual who on August 28, 2005, had a principal place of abode in the core disaster area and was hired during the two-year period beginning on such date for a position, the principal place of employment of which was located in the core disaster area; and (2) an individual who on August 28, 2005, had a principal place of abode in the core disaster area, who was displaced from such abode by reason of Hurricane Katrina and was hired during the period beginning on such date and ending on December 31, 2005 without regard to whether the new principal place of employment is in the core disaster area.

The present-law WOTC certification requirement was waived for such individuals. In lieu of the certification requirement, an individual may have provided to the employer reasonable evidence that the individual is a Hurricane Katrina employee.

The present-law rule that denies the credit with respect to wages of employees who had been previously employed by the employer was waived for the first hire of such employee as a Hurricane Katrina employee unless such employee was an employee of the employer on August 28, 2005.

Definitions

The term "Hurricane Katrina disaster area" means an area with respect to which a major disaster has been declared by the President before September 14, 2005 under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

The term "core disaster area" means that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the

Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Reasons for Change

In light of the economic deprivation that continues to be suffered as a result of Hurricane Katrina, the Committee believes that the work opportunity tax credit should continue to be available as an incentive to provide employment opportunities in the core disaster area of Hurricane Katrina.

Explanation of Provision

The provision extends through August 28, 2008, the work opportunity tax credit for certain Hurricane Katrina employees employed within the core disaster area. For this purpose, a Hurricane Katrina employee employed within the core disaster area is an individual who on August 28, 2005, had a principal place of abode in the core disaster area and is hired on or after August 28, 2005 and before August 29, 2008 for a position, the principal place of employment of which was located in the core disaster area.[127] The other special rules (e.g., certification and previous employment) for Hurricane Katrina employees apply.

Effective Date

The provision is effective for individuals hired after August 28, 2007, and before August 29, 2008.

[127] The prior-law work opportunity tax credit for Katrina employees hired to a new place of employment outside of the core disaster area is not extended by this provision.

C. Other Extenders

1. Disclosure of tax information to facilitate combined employment tax reporting (sec. 341 of the bill and sec. 6103 of the Code)

Present Law

Traditionally, Federal tax forms are filed with the Federal government and State tax forms are filed with individual States. This necessitates duplication of items common to both returns. The Code permits the IRS to disclose taxpayer identity information and signatures to any agency, body, or commission of any State for the purpose of carrying out with such agency, body or commission a combined Federal and State employment tax reporting program approved by the Secretary. The Federal disclosure restrictions, safeguard requirements, and criminal penalties for unauthorized disclosure and unauthorized inspection do not apply with respect to disclosures or inspections made pursuant to this authority.

The authority for this program expires December 31, 2007.

Under section 6103(c), the IRS may disclose a taxpayer's return or return information to such person or persons as the taxpayer may designate in a request for or consent to such disclosure. Pursuant to Treasury regulations, a taxpayer's participation in a combined return filing program between the IRS and a State agency, body or commission constitutes a consent to the disclosure by the IRS to the State agency of taxpayer identity information, signature and items of common data contained on the return. No disclosures may be made under this authority unless there are provisions of State law protecting the confidentiality of such items of common data.

Reasons for Change

Combined filing of Federal and State tax forms simplifies the filing obligations for taxpayers. As a result, the Committee believes it is appropriate to further extend the disclosure authority to facilitate combined employment tax reporting programs.

Explanation of Provision

The provision extends for one year (through December 31, 2008) the authority for the combined employment tax reporting program.

Effective Date

The provision applies to disclosures after December 31, 2007.

2. Disclosure of tax return information relating to terrorist activity (secs. 342 and 343 of the bill and sec. 6103 of the Code)

Present Law

In general

Section 6103 provides that returns and return information may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in the Internal Revenue Code. Section 6103 contains a number of exceptions to this general rule of nondisclosure that authorize disclosure in specifically identified circumstances (including nontax criminal investigations) when certain conditions are satisfied.

Disclosure provisions relating to emergency circumstances

The IRS is authorized to disclose return information to apprise Federal law enforcement agencies of danger of death or physical injury to an individual or to apprise Federal law enforcement agencies of imminent flight of an individual from Federal prosecution.[128] This authority has been used in connection with the investigation of terrorist activity.[129]

Disclosure provisions relating specifically to terrorist activity

Also among the disclosures permitted under the Code is disclosure of returns and return information for purposes of investigating terrorist incidents, threats, or activities, and for analyzing intelligence concerning terrorist incidents, threats, or activities. The term "terrorist incident, threat, or activity" is statutorily defined to mean an incident, threat, or activity involving an act of domestic terrorism or international terrorism.[130]

The term "international terrorism" means activities that involve violent acts or acts dangerous to human life that are a violation of the criminal laws of the United States or of any State, or that would be a criminal violation if committed within the jurisdiction of the United States or of any State; appear to be intended to intimidate or coerce a civilian population, to influence the policy of a government by intimidation or coercion, or to affect the conduct of a government by mass destruction, assassination, or kidnapping; and occur primarily outside the territorial jurisdiction of the United States, or transcend national boundaries in terms of the means by which they are accomplished, the persons they appear intended to intimidate or coerce, or the locale in which their perpetrators operate or seek asylum. The term "domestic terrorism"

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[128] Sec. 6103(i)(3)(B).

[129] See, Joint Committee on Taxation, *Disclosure Report for Public Inspection Pursuant to Internal Revenue Code Section 6103(p)(3)(C) for Calendar Year 2002 (JCX 29-04)* April 6, 2004.

[130] Sec. 6103(b)(11). For this purpose, "domestic terrorism" is defined in 18 U.S.C. sec. 2331(5) and "international terrorism" is defined in 18 U.S.C. sec. 2331(1).

means activities that involve acts dangerous to human life that are a violation of the criminal laws of the United States or of any State; appear to be intended to intimidate or coerce a civilian population, to influence the policy of a government by intimidation or coercion or to affect the conduct of a government by mass destruction, assassination, or kidnapping; and occur primarily within the territorial jurisdiction of the United States.

In general, returns and taxpayer return information must be obtained pursuant to an ex parte court order. Return information, other than taxpayer return information, generally is available upon a written request meeting specific requirements. The IRS also is permitted to make limited disclosures of such information on its own initiative to the appropriate Federal law enforcement agency.

No disclosures may be made under these provisions after December 31, 2007. The procedures applicable to these provisions are described in detail below.

Disclosure of returns and return information - by ex parte court order

Ex parte court orders sought by Federal law enforcement and Federal intelligence agencies

The Code permits, pursuant to an ex parte court order, the disclosure of returns and return information (including taxpayer return information) to certain officers and employees of a Federal law enforcement agency or Federal intelligence agency. These officers and employees are required to be personally and directly engaged in any investigation of, response to, or analysis of intelligence and counterintelligence information concerning any terrorist incident, threat, or activity. These officers and employees are permitted to use this information solely for their use in the investigation, response, or analysis, and in any judicial, administrative, or grand jury proceeding, pertaining to any such terrorist incident, threat, or activity.

The Attorney General, Deputy Attorney General, Associate Attorney General, an Assistant Attorney General, or a United States attorney, may authorize the application for the ex parte court order to be submitted to a Federal district court judge or magistrate. The Federal district court judge or magistrate would grant the order if based on the facts submitted he or she determines that: (1) there is reasonable cause to believe, based upon information believed to be reliable, that the return or return information may be relevant to a matter relating to such terrorist incident, threat, or activity; and (2) the return or return information is sought exclusively for the use in a Federal investigation, analysis, or proceeding concerning any terrorist incident, threat, or activity.

Special rule for ex parte court ordered disclosure initiated by the IRS

If the Secretary of the Treasury (or his delegate) possesses returns or return information that may be related to a terrorist incident, threat, or activity, the Secretary may, on his own initiative, authorize an application for an ex parte court order to permit disclosure to Federal law enforcement. In order to grant the order, the Federal district court judge or magistrate must determine that there is reasonable cause to believe, based upon information believed to be reliable, that the return or return information may be relevant to a matter relating to such terrorist incident, threat, or activity. The information may be disclosed only to the extent necessary to apprise the appropriate Federal law enforcement agency responsible for investigating or responding to a terrorist incident, threat, or activity and for officers and employees of that agency to investigate or respond to such terrorist incident, threat, or activity. Further, use of the information is limited to use in a Federal investigation, analysis, or proceeding concerning a terrorist incident, threat, or activity. Because the Department of Justice represents the Secretary in Federal district court, the Secretary is permitted to disclose returns and return information to the Department of Justice as necessary and solely for the purpose of obtaining the special IRS ex parte court order.

Disclosure of return information other than by ex parte court order

Disclosure by the IRS without a request

The Code permits the IRS to disclose return information, other than taxpayer return information, related to a terrorist incident, threat, or activity to the extent necessary to apprise the head of the appropriate Federal law enforcement agency responsible for investigating or responding to such terrorist incident, threat, or activity. The IRS on its own initiative and without a written request may make this disclosure. The head of the Federal law enforcement agency may disclose information to officers and employees of such agency to the extent necessary to investigate or respond to such terrorist incident, threat, or activity. A taxpayer's identity is not treated as return information supplied by the taxpayer or his or her representative.

Disclosure upon written request of a Federal law enforcement agency

The Code permits the IRS to disclose return information, other than taxpayer return information, to officers and employees of Federal law enforcement upon a written request satisfying certain requirements. The request must: (1) be made by the head of the Federal law enforcement agency (or his delegate) involved in the response to or investigation of terrorist incidents, threats, or activities, and (2) set forth the specific reason or reasons why such disclosure may be relevant to a terrorist incident, threat, or activity. The information is to be disclosed to officers and employees of the Federal law enforcement agency who would be personally and directly involved in the response to or investigation of terrorist incidents, threats, or activities. The information is to be used by such officers and employees solely for such response or investigation.

The Code permits the redisclosure by a Federal law enforcement agency to officers and employees of State and local law enforcement personally and directly engaged in the response to or investigation of the terrorist incident, threat, or activity. The State or local law enforcement agency must be part of an investigative or response team with the Federal law enforcement agency for these disclosures to be made.

Disclosure upon request from the Departments of Justice or the Treasury for intelligence analysis of terrorist activity

Upon written request satisfying certain requirements discussed below, the IRS is to disclose return information (other than taxpayer return information) to officers and employees of the Department of Justice, Department of the Treasury, and other Federal intelligence agencies, who are personally and directly engaged in the collection or analysis of intelligence and counterintelligence or investigation concerning terrorist incidents, threats, or activities. Use of the information is limited to use by such officers and employees in such investigation, collection, or analysis.

The written request is to set forth the specific reasons why the information to be disclosed is relevant to a terrorist incident, threat, or activity. The request is to be made by an individual who is: (1) an officer or employee of the Department of Justice or the Department of the Treasury, (2) appointed by the President with the advice and consent of the Senate, and (3) responsible for the collection, and analysis of intelligence and counterintelligence information concerning terrorist incidents, threats, or activities. The Director of the United States Secret Service also is an authorized requester.

Reasons for Change

It is important for the IRS to able to share information with other law enforcement and intelligence agencies in the effort to combat terrorism. As a result, the Committee believes it is appropriate to extend the disclosure authority relating to terrorist activities for another year.

Explanation of Provision

The provision extends for one year (though December 31, 2008) the disclosure authority relating to terrorist activities.

Effective Date

The provision is effective for disclosures after December 31, 2007.

3. Disclosure of return information to carry out income contingent repayment of student loans (sec. 344 of the bill and sec. 6103 of the Code)

Present Law

Present law prohibits the disclosure of returns and return information, except to the extent specifically authorized by the Code. An exception is provided for disclosure to the Department of Education (but not to contractors thereof) of a taxpayer's filing status, adjusted gross income and identity information (i.e., name, mailing address, taxpayer identifying number) to establish an appropriate repayment amount for an applicable student loan. The disclosure authority for the income-contingent loan repayment program is scheduled to expire after December 31, 2007.

The Department of Education utilizes contractors for the income-contingent loan verification program. The specific disclosure exception for the program does not permit disclosure of return information to contractors. As a result, the Department of Education obtains return information from the Internal Revenue Service by taxpayer consent (under section 6103(c)), rather than under the specific exception for the income-contingent loan verification program (sec. 6103(l)(13)).

Reasons for Change

The Committee believes it is appropriate to extend for an additional year the disclosure authority relating to income contingent student loans.

Explanation of Provision

The provision extends for one year (through December 31, 2008) the present law authority to disclose return information for purposes of the income-contingent loan repayment program.

Effective Date

The provision applies to requests made after December 31, 2007.

4. Extension of IRS authority to fund undercover operations (sec. 345 of the bill and sec. 7608 of the Code)

Present Law

IRS undercover operations are statutorily[131] exempt from the generally applicable restrictions controlling the use of Government funds (which generally provide that all receipts must be deposited in the general fund of the Treasury and all expenses be paid out of appropriated funds). In general, the Code permits the IRS to use proceeds from an undercover operation to pay additional expenses incurred in the undercover operation, through 2007. The IRS is required to conduct a detailed financial audit of large undercover operations in which the IRS is churning funds and to provide an annual audit report to the Congress on all such large undercover operations.

Reasons for Change

The Committee believes it is appropriate to extend the IRS's authority to use proceeds from undercover operations to pay additional enforcement expenses. This authority provides the IRS with an important enforcement tool and it is similar to the provided to other law enforcement agencies.

Explanation of Provision

The provision extends through 2008 the IRS's authority to use proceeds from an undercover operation to pay additional expenses incurred in the undercover operation.

Effective Date

The provision is effective on the date of enactment.

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[131] Sec. 7608(c).

5. Suspend limitation on rate of rum excise tax cover over to Puerto Rico and Virgin Islands (sec. 346 of the bill and sec. 7652(f) of the Code)

Present Law

A $13.50 per proof gallon[132] excise tax is imposed on distilled spirits produced in or imported (or brought) into the United States.[133] The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).[134]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[135] The amount of the cover over is limited under Code section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon during the period July 1, 1999 through December 31, 2007).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[136] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[137] All of the amounts covered over are subject to the limitation.

Reasons for Change

The Committee believes that, given the current fiscal needs of Puerto Rico and U.S. Virgin Islands, it is appropriate to extend the increase in the amount of the rum excise tax covered over to these possessions.

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[132] A proof gallon is a liquid gallon consisting of 50 percent alcohol. *See* sec. 5002(a)(10) and (11).

[133] Sec. 5001(a)(1).

[134] Secs. 5062(b), 7653(b) and (c).

[135] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

[136] Sec. 7652(e)(2).

[137] Secs. 7652(a)(3), (b)(3), and (e)(1).

Explanation of Provision

The provision suspends for one year the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover over amount of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2007 and before January 1, 2009. After December 31, 2008, the cover over amount reverts to $10.50 per proof gallon.

Effective Date

The change in the cover over rate is effective for articles brought into the United States after December 31, 2007.

6. Extension of disclosure authority to the Department of Veterans Affairs (sec. 347 of the bill and sec. 6103 of the Code)

Present Law

The Code prohibits disclosure of returns and return information, except to the extent specifically authorized by the Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the Internal Revenue Service ("IRS") to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

Among the disclosures permitted under the Code is disclosure of certain tax information to the Department of Veterans Affairs. Disclosure is permitted to assist the Department of Veterans Affairs in determining eligibility for, and establishing correct benefit amounts under, certain of its needs-based pension, health care, and other programs (sec. 6103(1)(7)(D)(viii)). The Department of Veterans Affairs disclosure provision was scheduled to expire after September 30, 2008.

Reasons for Change

The Committee believes it is appropriate to further extend this authority to ensure the correct payment of government benefits.

Explanation of Provision

The provision extends for three months (through December 31, 2008) the disclosure authority to the Department of Veteran's Affairs.

Effective Date

The provision is effective for requests made after September 30, 2008.

TITLE IV – MORTGAGE FORGIVENESS DEBT RELIEF

A. Exclude Discharges of Acquisition Indebtedness on Principal Residences from Gross Income (sec. 401 of the bill and sec. 108 of the Code)

Present Law

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108).[138] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities immediately after the discharge (sec. 1017).

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

For example, assume a taxpayer who is not in bankruptcy and is not insolvent owns a principal residence subject to a $200,000 mortgage debt for which the taxpayer has personal liability. If the creditor forecloses and the home is sold for $180,000 in satisfaction of the debt, the debtor has $20,000 income from the discharge of indebtedness which is includible in gross income. Likewise, if the creditor restructures the loan and reduces the principal amount to $180,000, the debtor has $20,000 includible in gross income.

Reasons for Change

The Committee believes that where taxpayers restructure their acquisition debt on a principal residence or lose their principal residence in a foreclosure, that it is inappropriate to treat discharges of acquisition indebtedness as income.

[138] A debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor (sec. 102).

Explanation of Provision

The bill excludes from the gross income of a taxpayer any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B) except that the dollar limit is $2 million ($1 million in the case of a separate return) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the refinancing does not exceed the amount of the refinanced indebtedness. For these purposes the term "principal residence" has the same meaning as under section 121 of the Code.

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by a recourse indebtedness of $1 million, of which $800,000 is qualified principal residence indebtedness. If the residence is sold for $700,000 and $300,000 debt is discharged, then only $100,000 of the amount discharged may be excluded from gross income under this provision.

The basis of the individual's principal residence is reduced by the amount excluded from income under the bill.

Under the bill, the exclusion does not apply to a taxpayer in a Title 11 case; instead the present-law exclusion applies. In the case of an insolvent taxpayer not in a Title 11 case, the exclusion under the bill applies unless the taxpayer elects to have the present-law exclusion apply instead.

Under the bill, the exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender.

Effective Date

The provision is effective for discharges of indebtedness on or after January 1, 2007.

B. Extend the Deduction for Private Mortgage Insurance (sec. 402 of the bill and sec. 163 of the Code)

Present Law

In general

Present law provides that qualified residence interest is deductible notwithstanding the general rule that personal interest is nondeductible (sec. 163(h)).

Acquisition indebtedness and home equity indebtedness

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is $100,000. The maximum amount of acquisition indebtedness is $1 million. Acquisition indebtedness means debt that is incurred in acquiring constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

Private mortgage insurance

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of married individual filing a separate return).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration, and private mortgage insurance (defined in section 2 of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Administration).

The provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates for any amount paid or accrued after December 31, 2007, or properly allocable to any period after that date.

Reporting rules apply under the provision.

Reasons for Change

The Committee believes it is appropriate to extend the present-law temporary provision. The Committee understands that the purpose of the provisions permitting deduction of home mortgage interest is to encourage home ownership while limiting significant disincentives to saving. The Committee believes that it would be consistent with the purpose of the provisions permitting deduction of home mortgage interest to permit the deduction of mortgage insurance premiums. While these premiums are not in the nature of interest, the Committee notes that purchase of such insurance is often demanded by lenders in order for home buyers to obtain financing (depending on the size of the buyer's down payment). The Committee believes that permitting deductibility of premiums for this type of insurance connected with home purchases will foster home ownership. In the case of higher income taxpayers who may not purchase mortgage insurance, however, the Committee believes the incentive of deductibility becomes unnecessary, and a phase-out is appropriate. It is not intended that prepayments be currently deductible, but rather, that they be deductible only in the period to which they relate. Reporting of payments is generally necessary to administer the provision.

Explanation of Provision

The provision extends the deduction for private mortgage insurance to amounts paid or accrued after December 31, 2007, but only with respect to contracts entered into after December 31, 2006, and prior to January 1, 2015.

Effective Date

The provision applies to contracts entered into after December 31, 2006, and before January 1, 2015, with respect to amounts paid or accrued after December 31, 2007.

C. Alternative Tests for Qualifying as Cooperative Housing Corporation (sec. 403 of the bill and sec. 216 of the Code)

Present Law

A tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid or accrued to the cooperative to the extent those amounts represent the tenant-stockholder's proportionate share of (1) real estate taxes allowable as a deduction to the cooperative which are paid or incurred by the cooperative on the cooperative's land or buildings and (2) interest allowable as a deduction to the cooperative that is paid or incurred by the cooperative on its indebtedness contracted in the acquisition of the cooperative's land or in the acquisition, construction, alteration, rehabilitation, or maintenance of the cooperative's buildings.

A cooperative housing corporation generally is a corporation (1) that has one class of stock, (2) each of the stockholders of which is entitled, solely by reason of ownership of stock in the corporation, to occupy a dwelling owned or leased by the cooperative, (3) no stockholder of which is entitled to receive any distribution not out of earnings and profits of the cooperative, except on complete or partial liquidation of the cooperative, and (4) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest are paid or incurred is derived from tenant-stockholders.

Reasons for Change

Under present law, tenant-stockholders of a cooperative housing corporation are allowed to deduct their proportionate shares of the cooperative's deductible real estate taxes and mortgage interest only if the cooperative's nonmember income is no more than 20 percent of its total gross income. To satisfy this rule, some cooperative housing corporations have made rentals to commercial tenants at below-market rates. The Committee believes that the tax rules should not create an incentive to charge below-market-rate rents. Accordingly, the Committee's bill provides two non-income-based alternatives to the 80-percent requirement of present law.

Explanation of Provision

The provision amends the fourth requirement listed above to provide that the requirement is satisfied if, for the taxable year in which the taxes and interest are paid or incurred, the corporation meets one of the following three requirements: (1) 80 percent or more of the corporation's gross income for that taxable year is derived from tenant-stockholders (the present law requirement); (2) at all times during that table year 80 percent or more of the total square footage of the corporation's property is used or available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use; or (3) 90 percent or more of the expenditures of the corporation paid or incurred during that taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of tenant-stockholders.

Effective Date

The provision is effective for taxable years ending after the date of enactment.

D. Exclusion of Gain on Sale of a Principal Residence Not to Apply to Nonqualified Use (sec. 404 of the bill and sec. 121 of the Code)

Present Law

In general

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

Present law also contains an election relating to members of the uniformed services, the Foreign Service, and certain employees of the intelligence community.[139] If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to 10 years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty. For these purposes, 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. The election may be made with respect to only one property for a suspension period.

The exclusion does not apply to gain to the extent the gain is attributable to depreciation allowable with respect to the rental or business use of a principal residence for periods after May 6, 1997.

Reasons for Change

The present-law exclusion of gain on principal residences has many beneficial effects by encouraging home ownership. The Committee believes that the application of present-law to exclude gain attributable to periods of use prior to a home's use as a principal residence is not consistent with the purpose of the present-law exclusion and inappropriate. The Committee believes that the provision limits the application of the exclusion to use as a principal residence without imposing undue computational and record-keeping burdens on the taxpayer or the Internal Revenue Service.

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[139] The provision relating to employees of the intelligence community is effective for sales and exchanges before January 1, 2011.

Explanation of Provision

Under the bill, gain from the sale or exchange of a principal residence allocated to periods of nonqualified use is not excluded from gross income. The amount of gain allocated to periods of nonqualified use is the amount of gain multiplied by a fraction the numerator of which is the aggregate periods of nonqualified use during the period the property was owned by the taxpayer and the denominator of which is the period the taxpayer owned the property.

A period of nonqualified use means any period (not including any period before January 1, 2008) during which the property is not used by the taxpayer or the taxpayer's spouse or former spouse as a principal residence. For purposes of determining periods of nonqualified use, (i) any period after the last date the property is used as the principal residence of the taxpayer or spouse (regardless of use during that period), and (ii) any period (not to exceed two years) that the taxpayer is temporarily absent by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances, are not taken into account. The present-law election for the uniformed services, Foreign Service and employees of the intelligence community is unchanged.

If any gain is attributable to post-May 6, 1997, depreciation, the exclusion does not apply to that amount of gain, as under present law, and that gain is not taken into account in determining the amount of gain allocated to nonqualified use.

These provision may be illustrated by the following examples:

Example 1.–Assume that an individual buys a property on January 1, 2008, for $400,000, and uses it as rental property for two years claiming $20,000 of depreciation deductions. On January 1, 2010, the taxpayer converts the property to his principal residence. On January 1, 2012, the taxpayer moves out, and the taxpayer sells the property for $700,000 on January 1, 2013. As under present law, $20,000 gain attributable to the depreciation deductions is included in income. Of the remaining $300,000 gain, 40% of the gain (2 years divided by 5 years), or $120,000, is allocated to nonqualified use and is not eligible for the exclusion. Since the remaining gain of $180,000 is less than the maximum gain of $250,000 that may be excluded, gain of $180,000 is excluded from gross income.

Example 2.–Assume that an individual buys a principal residence on January 1, 2008, for $400,000, moves out on January 1, 2018, and on December 1, 2020 (more that two years after it was last used as the principal residence) sells the property for $600,000. The entire $200,000 gain is excluded from gross income, as under present law.

Effective Date

The provision is effective for sales and exchanges after December 31, 2007.

TITLE V – ADMINISTRATIVE PROVISIONS

A. Repeal of Private Tax Collection Contracts (sec. 501 of the bill and sec. 6306 of the Code)

Present Law

The Secretary has general authority to administer and enforce the tax laws. Present law also provides specific authority for the collection of taxes. Under present law, the IRS may 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.

Present law provides for payments to private debt collection companies to be made from the amount collected pursuant to a private debt collection contract, but not in excess of 25 percent of the amount collected. Present law also permits the IRS to retain an amount not in excess of 25 percent from the amount collected pursuant to a private debt collection contract for additional enforcement activities.

Reasons for Change

Over 130 years ago, this Committee stated that “any system of farming the collection of any portion of the revenue of the Government is fundamentally wrong . . . No necessity for such laws exist . . . the Secretary of the Treasury and the head of the Internal Revenue Bureau are empowered by law to make all collections of taxes . . .. The Internal Revenue Bureau is possessed of full knowledge of the laws relating to the collection of the revenue . . . and has all the machinery necessary for their full and complete enforcement.”[140] The Committee believes these words remain true today.

The Committee believes that the collection of federal income taxes is an inherently governmental function that should be restricted to IRS employees. The Committee believes that the use of private contractors to collect Federal tax debt violates the special and confidential relationship between taxpayers and the Federal government. The Committee believes that the use of private contractors jeopardizes the privacy of taxpayers and undermines long-term taxpayer compliance.

The IRS Commissioner has stated on numerous times before the Committee that IRS employees can collect Federal taxes more efficiently than private debt collection companies. IRS employees have access to a taxpayer’s complete file and history, including the most recent information relating to tax filings and compliance data. Access to the taxpayer’s complete file allows IRS employees to collect outstanding tax debt more efficiently and in a manner that ensures long-term compliance with the tax laws. The Committee believes that only IRS employees should be allowed to perform tax collection activities. It is the Committee’s view that the IRS take immediate and appropriate action to ensure that IRS employees being laid off at IRS

[140] H.R. Rep. No. 43-559, 1st Sess. (1874).

processing centers be provided training and employment opportunities at IRS Automated Collection System (ACS) sites, including out-bound call collection activities, and that the IRS expand ACS activities as appropriate to ensure proper levels of collection activities.

Explanation of Provision

The provision repeals the authority for the IRS to enter into, renew, or extend any private debt collection contract.

Effective Date

The provision generally is effective on the date of enactment, except for any contract which was entered into before July 18, 2007, and is not renewed or extended after such date. The provision also provides that any private debt collection contract which is entered into on or after July 18, 2007, and any extension or renewal on or after such date of any private debt collection contract shall be void.

B. Delayed Implementation of Government Withholding (sec. 502 of the bill and sec. 3402(t) of the Code)

Present law

For payments made after December 31, 2010, the Code requires withholding at a three-percent rate on certain payments to persons providing property or services made by the Government of the United States, every State, every political subdivision thereof, and every instrumentality of the foregoing (including multi-State agencies). The withholding requirement applies regardless of whether the government entity making such payment is the recipient of the property or services. Political subdivisions of States (or any instrumentality thereof) with less than $100 million of annual expenditures for property or services that would otherwise be subject to withholding under this provision are exempt from the withholding requirement.

Payments subject to the three-percent withholding include any payment made in connection with a government voucher or certificate program which functions as a payment for property or services. For example, payments to a commodity producer under a government commodity support program are subject to the withholding requirement. The provision imposes information reporting requirements on payments subject to withholding under the provision.

The three-percent withholding requirement does not apply to any payments made through a Federal, State, or local government public assistance or public welfare program for which eligibility is determined by a needs or income test. The three-percent withholding requirement also does not apply to payments of wages or to any other payment with respect to which mandatory (e.g., U.S.-source income of foreign taxpayers) or voluntary (e.g., unemployment benefits) withholding applies under present law. The provision does not exclude payments that are potentially subject to backup withholding under section 3406. If, however, payments are actually being withheld under backup withholding, the three-percent withholding requirement does not apply.

The three-percent withholding requirement also does not apply to the following: payments of interest; payments for real property; payments to tax-exempt entities or foreign governments; intra-governmental payments; payments made pursuant to a classified or confidential contract (as defined in section 6050M(e)(3)); and payments to a government employee that are not otherwise excludable from the new withholding provision with respect to the employee's services as an employee.

Reasons for Change

The Committee understands that the three-percent withholding requirement presents a number of challenges for the government entities and taxpayers subject to the requirement. The Committee believes the Treasury should conduct a study of the issues confronting both businesses and governments in complying with the three-percent requirement, as well as the issues confronting Treasury and the IRS in administering such requirement. Thus, the Committee believes it is appropriate to delay the effective date of the three-percent withholding requirement by one year to allow the Secretary further time to study issues associated with the requirement and to provide Congress with time to review and respond to the results of such study.

Explanation of Provision

The provision delays the effective date for the three-percent withholding requirement. Under the provision, the requirement applies to payments made after December 31, 2011.

The provision directs the Secretary to study issues associated with the three-percent withholding requirement, including (1) the problems, if any, which are anticipated in administering and complying with such requirement, (2) the burdens, if any, that such requirements will place on small businesses (taking into account such mechanisms as may be necessary to administer such requirements), and (3) the application of such requirements to small expenditures for services and goods by governments.

The Secretary is to submit his report to the House Committee on Ways and Means and the Senate Committee on Finance no later than six months after the date of enactment.

Effective Date

The provision is effective on the date of enactment.

C. Application of Statute of Limitations Rules to Persons Claiming U.S. Virgin Islands Residency (sec. 503 of the bill and sec. 932 of the Code)

Present Law

Return filing rules for Virgin Islands residents

An individual who is a bona fide resident of the U.S. Virgin Islands ("USVI") or who files a joint return with a person who is a bona fide USVI resident must file an income tax return with the USVI.[141] For any taxable year ending after October 22, 2004 the bona fide residence requirement for application of this return filing rule must be satisfied for the entire taxable year.[142] For taxable years ending on or before October 22, 2004, section 932(c)(1)(A) provided that bona fide residence was tested at the close of the taxable year.

For an individual (1) who is a bona fide resident of the USVI, (2) who, on the income tax return filed with the USVI, reports income from all sources and identifies the source of each item shown on the return, and (3) who fully pays the tax liability resulting from the income shown on the return, for purposes of calculating income tax liability to the United States, gross income does not include any amount included in gross income on the USVI return, and allocable deductions and credits are not taken into account.[143] Accordingly, an individual who is a bona fide USVI resident generally may satisfy the individual's U.S. return-filing and income tax payment obligations by filing an income tax return with the USVI and paying income tax to the USVI.

Statute of limitations

The IRS generally must assess tax within three years after the due date for the return to which the assessment relates.[144]

In certain circumstances, the three-year statute of limitations does not apply, and the IRS may assess tax at any time. These circumstances include the filing of a false or fraudulent return with the intent to evade tax; a willful attempt to defeat or evade tax; and the failure to file a return.

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[141] Sec. 932(c)(1), (2).

[142] Sec. 932(c)(1)(A).

[143] Sec. 932(c)(4).

[144] Sec. 6501(a), (b)(1).

Statute of limitations for USVI residents

In guidance published in 1999, the IRS concluded that when a U.S. citizen who was a bona fide resident of the USVI timely filed a USVI income tax return but failed to report on that return a U.S.-source dividend, the three-year statute of limitations period began to run with the filing of the USVI return and the IRS was precluded from assessing tax after expiration of the three-year period.[145] In 2006 guidance, the IRS concluded that when a U.S. citizen who timely files a USVI income tax return fails to satisfy a requirement of section 932(c)(4) (because, for example, the individual is not a bona fide USVI resident or does not report all income on the USVI return), the three-year statute of limitations period does not begin to run until the individual also files a return with the IRS.[146]

In 2007 guidance, the IRS provided rules for the application of the three-year statute of limitations period and the section 932(c) return filing requirements to a U.S. citizen or resident who claims status as a bona fide USVI resident.[147] As a result of this guidance, for taxable years ending on or after December 31, 2006, the three-year statute of limitations period for every U.S. citizen or resident claiming to be a bona fide USVI resident generally begins when the individual files an income tax return with the USVI.

The rules in the 2007 guidance for an individual who claims bona fide USVI residence for a taxable year ending before December 31, 2006 differ based on whether the individual is a "covered person" or a non-covered person. A covered person is a U.S. citizen or resident alien who takes the position that he or she is a bona fide USVI resident, files a USVI income tax return, and has less than $75,000 gross income for the taxable year. A covered person generally may claim application of the three-year statute of limitations period for a taxable year ending before December 31, 2006 based on that person's filing of a USVI income tax return for that year. A non-covered person may start the running of the three-year limitations period for a taxable year ending before December 31, 2006 by filing an income tax return for that year with the IRS and reporting on that return no gross income and no taxable income. The three-year limitations period starts with the filing of the return with the IRS.

Reasons for Change

The Committee believes it is unfair to apply different statute of limitations rules to U.S. citizens who claim to be bona fide USVI residents and who file USVI income tax returns than to other U.S. citizens who file income tax returns with the IRS. The 1986 Tax Reform Act provided that residents of the USVI are required to file income tax returns only with the USVI. The Committee believes that the guidance issued by the IRS in 2006 and 2007 represents a

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145 Field Service Advice Memorandum 199906031 (Feb. 12, 1999).

146 Chief Counsel Advice Memorandum 200624002 (June 16, 2006).

147 Notice 2007-19, 2007-11 I.R.B. 689 (Mar. 12, 2007); Notice 2007-31, 2007-16 I.R.B. 971 (Apr. 16, 2007).

misapplication of present law. In particular, the Committee objects to the retroactive denial of statute of limitations protections caused by the 2006 IRS guidance. The IRS notices issued in 2007 ameliorate but do not eliminate this retroactive effect because, for taxable years ending before December 31, 2006, the notices differentiate among taxpayers based on income.

Explanation of Provision

The provision provides generally that an income tax return filed with the USVI by an individual claiming to be a bona fide USVI resident will be treated for purposes of subtitle F of the Code (Procedure and Administration) in the same manner as if the return were an income tax return filed with the United States for that year. Consequently, under the provision the filing of a USVI income tax return by any individual claiming status as a bona fide USVI resident generally starts the three-year limitations period. This rule does not, however, apply if the return filed with the USVI is false or fraudulent with the intent to evade tax or otherwise is a willful attempt in any manner to defeat or evade tax.

Effective Date

The provision applies to taxable years beginning after 1986.

D. Revision of Tax Rules on Expatriation of Individuals (sec. 504 of the bill and new secs. 877A and 2801 of the Code)

Present Law

In general

Income tax

U.S. citizens and residents generally are subject to U.S income taxation on their worldwide income. The U.S. tax may be reduced or offset by a credit allowed for foreign income taxes paid with respect to foreign source income. Nonresident aliens are taxed at a flat rate of 30 percent (or a lower treaty rate) on certain types of passive income derived from U.S. sources, and at regular graduated rates on net profits derived from a U.S. trade or business.

Certain special rules (sections 671-679) apply to certain trust interests deemed to be owned by the grantor or other person (a "grantor trust"). In that case, the deemed owner must include in income the items of income and deduction (and credits against tax) of the portion of such trust deemed to be owned by such person.

Except to the extent a trust is a grantor trust, a transfer of property by a U.S. person to a foreign estate or trust is treated (under section 684) by the transferor as if the property had been sold to such estate or trust. The same rule applies if a domestic trust becomes a foreign trust.

Estate tax

The estates of U.S. citizens and residents are subject to estate tax on all property, wherever located. The estates of nonresident aliens generally are subject to estate tax on U.S.-situated property (e.g., real estate and tangible property located within the United States and stock in a U.S. corporation).

Gift tax

U.S. citizens and residents generally are subject to gift tax on transfers by gift of any property, wherever situated. Nonresident aliens generally are subject to gift tax on transfers by gift of U.S.-situated property (e.g., real estate and tangible property located within the United States), but excluding intangibles, such as stock, regardless of where they are located.

Income tax rules with respect to expatriates

For the 10 taxable years after an individual relinquishes his or her U.S. citizenship or terminates his or her U.S. long-term residency, unless certain conditions are met, the individual is subject to an alternative method of income taxation than that generally applicable to nonresident aliens (the "alternative tax regime"). Generally, the individual is subject to income tax for the 10-year period at the rates applicable to U.S. citizens, but only on U.S.-source income.[148]

A "long-term resident" is a noncitizen who is a lawful permanent resident of the United States for at least eight taxable years during the period of 15 taxable years ending with the taxable year during which the individual either ceases to be a lawful permanent resident of the United States or commences to be treated as a resident of a foreign country under a tax treaty between such foreign country and the United States (and does not waive such benefits).

A former citizen or former long-term resident is subject to the alternative tax regime for a 10-year period following citizenship relinquishment or residency termination, unless the former citizen or former long-term resident: (1) establishes that his or her average annual net income tax liability for the five preceding years does not exceed $124,000 (adjusted for inflation after 2004) and his or her net worth is less than $2 million, or alternatively satisfies limited, objective exceptions for certain dual citizens and minors who have had no substantial contacts with the United States; and (2) certifies under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years and provides such evidence of compliance as the Secretary may require.

Anti-abuse rules are provided to prevent the circumvention of the alternative tax regime.

Estate tax rules with respect to expatriates

Special estate tax rules apply to individuals who die during a taxable year in which they are subject to the alternative tax regime. Under these special rules, certain closely-held foreign stock owned by the former citizen or former long-term resident is includible in his or her gross estate to the extent that the foreign corporation owns U.S.-situated assets. The special rules apply if, at the time of death, the former citizen or former long-term resident: (1) owns, directly or indirectly, 10 percent or more of the total combined voting power of all classes of stock of the foreign corporation entitled to vote; and (2) is considered to own, directly or indirectly, more than 50 percent of (a) the total combined voting power of all classes of stock of the foreign corporation entitled to vote, or (b) the total value of the stock of such corporation. If this stock ownership test is met, then the gross estate of the former citizen or former long-term resident includes that proportion of the fair market value of the foreign stock owned by the individual at the time of death, which the fair market value of any assets owned by such foreign corporation and situated in the United States (at the time of death) bears to the total fair market value of all assets owned by such foreign corporation (at the time of death).

Gift tax rules with respect to expatriates

Special gift tax rules apply to individuals who make gifts during a taxable year in which they are subject to the alternative tax regime. The individual is subject to gift tax on gifts of

[148] For this purpose, however, U.S.-source income has a broader scope than it does typically in the Code.

U.S.-situated intangibles made during the 10 years following citizenship relinquishment or residency termination. In addition, gifts of stock of certain closely-held foreign corporations by a former citizen or former long-term resident are subject to gift tax, if the gift is made during the time that such person is subject to the alternative tax regime. The operative rules with respect to these gifts of closely-held foreign stock are the same as described above relating to the estate tax, except that the relevant testing and valuation date is the date of gift rather than the date of death.

Termination of U.S. citizenship or long-term resident status for U.S. Federal income tax purposes

An individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes, including for purposes of section 7701(b)(10), until the individual: (1) gives notice of an expatriating act or termination of residency (with the requisite intent to relinquish citizenship or terminate residency) to the Secretary of State or the Secretary of Homeland Security, respectively; and (2) provides a statement to the Secretary of the Treasury in accordance with section 6039G.

Sanction for individuals subject to the individual tax regime who return to the United States for extended periods

The alternative tax regime does not apply to any individual for any taxable year during the 10-year period following citizenship relinquishment or residency termination if such individual is present in the United States for more than 30 days in the calendar year ending in such taxable year. Such individual is treated as a U.S. citizen or resident for such taxable year and, therefore, is taxed on his or her worldwide income.

Similarly, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any calendar year ending during the 10-year period following citizenship relinquishment or residency termination, and the individual dies during that year, he or she is treated as a U.S. resident, and the individual's worldwide estate is subject to U.S. estate tax. Likewise, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any year during the 10-year period following citizenship relinquishment or residency termination, the individual is subject to U.S. gift tax on any transfer of his or her worldwide assets by gift during that taxable year.

For purposes of these rules, an individual is treated as present in the United States on any day if such individual is physically present in the United States at any time during that day. The present-law exceptions to the U.S. presence rules for residency purposes[149] generally do not apply. However, for individuals with certain ties to countries other than the United States[150] and

[149] Secs. 7701(b)(3)(D), 7701(b)(5), and 7701(b)(7)(B)-(D).

[150] An individual has such a relationship to a foreign country if (1) the individual becomes a citizen or resident of the country in which the individual was born, such individual's spouse was born, or either of the individual's parents was born, and (2) the individual becomes fully liable for income tax in such country.

individuals with minimal prior physical presence in the United States,[151] a day of physical presence in the United States is disregarded if the individual is performing services in the United States on such day for an unrelated employer (within the meaning of sections 267 and 707(b)), that meets such requirements as the Secretary may prescribe in regulations. No more than 30 days may be disregarded during any calendar year under this rule.

Annual return

Former citizens and former long-term residents are required to file an annual return for each year in which they are subject to the alternative tax regime. The annual return is required even if no U.S. Federal income tax is due. The annual return requires certain information, including information on the permanent home of the individual, the individual's country of residence, the number of days the individual was present in the United States for the year, and detailed information about the individual's income and assets that are subject to the alternative tax regime. This requirement includes information relating to foreign stock potentially subject to the special estate and gift tax rules.

If the individual fails to file the statement in a timely manner or fails correctly to include all the required information, the individual is required to pay a penalty of $10,000. The $10,000 penalty does not apply if it is shown that the failure is due to reasonable cause and not to willful neglect.

Reasons for Change

The Committee is aware that each year some individuals relinquish their U.S. citizenship or terminate their long-term U.S. residency for the purpose of avoiding U.S. income, estate, and gift taxes. By so doing, such individuals may reduce their annual U.S. income tax liability and may reduce or eliminate their future U.S. estate or gift tax liability.

The Committee recognizes that citizens and long-term residents of the United States have a right not only to physically leave the United States to live elsewhere, but also to relinquish their citizenship or terminate their residency. The Committee does not believe that the Internal Revenue Code should be used to stop U.S. citizens and long-term residents from relinquishing citizenship or terminating residency; however, the Committee also does not believe that the Code should provide a tax incentive for doing so. In other words, to the extent possible, an individual's decision to relinquish citizenship or terminate long-term residency should be tax-neutral.

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[151] An individual has a minimal prior physical presence in the United States if the individual was physically present for no more than 30 days during each year in the ten-year period ending on the date of loss of United States citizenship or termination of residency. However, for purposes of this test, an individual is not treated as being present in the United States on a day if the individual remained in the United States because of a medical condition that arose while the individual was in the United States. Sec. 7701(b)(3)(D)(ii).

The Committee recognizes that the American Jobs Creation Act of 2004 altered prior law regarding expatriation in a number of respects, including replacing the subjective "principal purpose of tax avoidance test" with objective rules. Notwithstanding these changes, the Committee remains concerned that the present-law expatriation tax rules (as modified in 2004) could be made more effective. In addition, the Committee is concerned that the alternative method of taxation under section 877 can be avoided by postponing the realization of U.S.-source income for 10 years.

Consequently, the Committee believes that the present-law expatriation tax rules should be augmented by a new tax regime applicable to former citizens and long-term residents. Because U.S. citizens and residents who retain their citizenship or residency generally are subject to income tax on accrued appreciation when they dispose of their assets, as well as estate tax on the full value of assets that are held until death, the Committee believes it fair to tax individuals on the appreciation in their assets when they relinquish their citizenship or terminate their long-term residency. The Committee believes that an exception from such a tax should be provided for individuals with a relatively modest amount of income and net worth, or appreciated assets. The Committee also believes that, where U.S. estate or gift taxes are avoided with respect to a transfer of property to a U.S. person by reason of the expatriation of the donor, it is appropriate for the recipient to be subject to a transfer tax similar to the avoided transfer taxes.

Explanation of Provision

In general

In general, the provision imposes tax on certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who terminate their U.S. residency. Such individuals are subject to income tax on the net unrealized gain in their property as if the property had been sold for its fair market value on the day before the expatriation or residency termination ("mark-to-market tax"). Gain from the deemed sale is taken into account at that time without regard to other Code provisions. Any loss from the deemed sale generally is taken into account to the extent otherwise provided in the Code, except that the wash sale rules of section 1091 do not apply. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000. The $600,000 amount is increased by a cost of living adjustment factor for calendar years after 2008. Any gains or losses subsequently realized are to be adjusted for gains and losses taken into account under the deemed sale rules, without regard to the $600,000 exemption.

The mark-to-market tax described above applies to most types of property interests held by the individual on the date of relinquishment of citizenship or termination of residency, with certain exceptions. Deferred compensation items, interests in nongrantor trusts, and specified tax deferred accounts are excepted from the mark-to-market tax but are subject to the special rules described below.

In addition, the provision imposes a transfer tax on certain transfers to U.S. persons from certain U.S. citizens who relinquished their U.S. citizenship and certain long-term U.S. residents who terminated their U.S. residency, or from their estates.

Individuals covered

The provision applies to any U.S. citizen who relinquishes citizenship and any long-term resident who terminates U.S. residency, if such individual ("covered expatriate") (1) has an average annual net income tax liability for the five preceding years ending before the date of the loss of U.S. citizenship or residency termination that exceeds $124,000 (as adjusted for inflation after 2004 – $136,000 in 2007[152]); (2) has a net worth of $2 million or more on such date; or (3) fails to certify under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years or fails to submit such evidence of compliance as the Secretary may require.

Exceptions to an individual's classification as a covered expatriate due to (1) or (2) above (but not (3)) are provided in two situations. The first exception applies to an individual who was born with citizenship both in the United States and in another country; provided that (1) as of the expatriation date the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual has been a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for not more than 10 taxable years during the 15-year taxable year period ending with the taxable year of expatriation. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18½, provided that the individual was a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for no more than 10 taxable years before such relinquishment.

The definition of "long-term resident" under the provision is generally the same as that under present law. As under present law, an individual is considered to terminate long-term U.S. residency when the individual ceases to be a lawful permanent resident of the United States (i.e., loses his or her green card status through revocation or has been administratively or judicially determined to have abandoned such status). Under the provision, however, an individual ceases to be treated as a lawful permanent resident of the United States for all tax purposes (including for purposes of section 877) if such individual commences to be treated as a resident of a foreign country under a tax treaty between the United States and such foreign country, does not waive the benefits of the treaty applicable to residents of such foreign country, and notifies the Secretary of the commencement of such treatment.

The provision provides that, for all tax purposes (including for purposes of section 877), a U.S. citizen continues to be treated as a U.S. citizen for tax purposes until that individual's citizenship is treated as relinquished under the rules of the immediately preceding paragraph. However, under Treasury regulations, relinquishment may occur earlier with respect to an individual who became at birth a citizen of the United States and of another country. For purposes of the provision, an individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates: (1) the date that the individual renounces U.S. nationality before a diplomatic or consular officer of the United States (provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (2) the date that the individual furnishes to the State Department a signed statement of voluntary relinquishment of

[152] Rev. Proc. 2006-53, sec. 3.29, 2006-48 I.R.B. 996.

U.S. nationality confirming the performance of an expatriating act (again, provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (3) the date that the State Department issues a certificate of loss of nationality; or (4) the date that a U.S. court cancels a naturalized citizen's certificate of naturalization.

In the case of a long-term resident, the date that long-term residency is terminated is the "expatriation date." In the case of a citizen, the date that the individual relinquishes citizenship is the "expatriation date."

The foregoing rules replace the present-law rules that provide that an individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes until the individual gives notice of an expatriating act or termination of residency.

If an individual who is a covered expatriate becomes subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, the individual is not treated as a covered expatriate during that period for purposes of applying the withholding rules relating to deferred compensation items, the rules relating to interests in nongrantor trusts, and the rules relating to gifts and bequests from covered expatriates. If the individual again relinquishes citizenship or terminates long-term residency (after meeting anew the requirements to become a long-term resident), the mark-to-market tax and other provisions are re-triggered with the new expatriation date.

Deferral of payment of mark-to-market tax

Under the provision, an individual may elect to defer payment of the mark-to-market tax imposed on the deemed sale of property. Interest is charged for the period the tax is deferred at the rate normally applicable to individual underpayments. The election is irrevocable and is made on a property-by-property basis. Under the election, the deferred tax attributable to a particular property is due when the return is due for the taxable year in which the property is disposed (or, if the property is disposed of in a transaction in which gain is not recognized in whole or in part, at such other time as the Secretary may prescribe). The deferred tax attributable to a particular property is an amount which bears the same ratio to the total mark-to-market tax as the gain taken into account with respect to such property bears to the total gain taken into account for the mark-to-market tax. The deferral of the mark-to-market tax may not be extended beyond the due date of the return for the taxable year which includes the individual's death.

In order to elect deferral of the mark-to-market tax, the individual is required to furnish a bond to the Secretary. The bond must be conditioned upon payment of the amount of tax due, plus interest thereon, and must be in accordance with such requirements relating to terms, conditions, form of the bond, and sureties, as may be specified by regulations. The bond must be accepted by the Secretary. Other security mechanisms, including letters of credit, are permitted provided that they meet such requirements as the Secretary may prescribe. In the event that the security provided with respect to a particular property subsequently fails to meet the requirements of these rules and the individual fails to correct such failure, the deferred tax and the interest with respect to such property will become due. As a further condition to making the election, the individual is required to consent to the waiver of any treaty rights that would preclude the assessment or collection of the tax.

Deferred compensation items

The provision contains special rules for interests in deferred compensation items. For purposes of the provision, a "deferred compensation item" means any interest in a plan or arrangement described in section 219(g)(5), any interest in a foreign pension plan or similar retirement arrangement or program, any item of deferred compensation, and any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83 or in accordance with section 83.

The plans and arrangements described in section 219(g)(5) are (i) a plan described in section 401(a), which includes a trust exempt from tax under section 501(a); (ii) an annuity plan described in section 403(a); (iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, but excluding an eligible deferred compensation plan (within the meaning of section 457(b)); (iv) an annuity contract described in section 403(b); (v) a simplified employee pension (within the meaning of section 408(k)); (vi) a simplified retirement account (within the meaning of section 408(p)); and (vii) a trust described in section 501(c)(18).

If a deferred compensation item is an eligible deferred compensation item, the payor must deduct and withhold from a "taxable payment" to the covered expatriate a tax equal to 30 percent of such taxable payment. This withholding requirement is in lieu of any withholding requirement under present law. A taxable payment is subject to withholding to the extent it would be included in gross income of the covered expatriate if such person were subject to tax as a citizen or resident of the United States. A deferred compensation item is taken into account as a payment when such item would be so includible. A deferred compensation item that is subject to the 30 percent withholding requirement is subject to tax under section 871.

If a deferred compensation item is not an eligible deferred compensation item, an amount equal to the present value of the covered expatriate's deferred compensation item is treated as having been received on the day before the expatriation date. In the case of a deferred compensation item that is subject to section 83, the item is treated as becoming transferable and no longer subject to a substantial risk of forfeiture on the day before the expatriation date. Appropriate adjustments shall be made to subsequent distributions to take into account the foregoing treatment. In addition, these deemed distributions are not subject to early distribution tax. For this purpose, "early distribution tax" means any increase in tax imposed under section 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4).

An "eligible deferred compensation item" means any deferred compensation item with respect to which (i) the payor is either a U.S. person or a non-U.S. person who elects to be treated as a U.S. person for purposes of withholding and who meet the requirements prescribed by the Secretary to ensure compliance with the withholding requirements, and (ii) the covered expatriate notifies the payor of his status as a covered expatriate and irrevocably waives any claim of withholding reduction under any treaty with the United States.

The foregoing taxing rules regarding eligible deferred compensation items and items that are not eligible deferred compensation items do not apply to deferred compensation items that are attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

Specified tax deferred accounts

There are special rules for interests in specified tax deferred accounts. If a covered expatriate holds any interest in a specified tax deferred account on the day before the expatriation date, such covered expatriate is treated as receiving a distribution of his entire interest in such account on the day before the expatriation date. Appropriate adjustments are made for subsequent distributions to take into account this treatment. As with deferred compensation items, these deemed distributions are not subject to early distribution tax.

The term "specified tax deferred account" means an individual retirement plan (as defined in section 7701(a)(37)), a qualified tuition plan (as defined in section 529), a Coverdell education savings account (as defined in section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220). However, simplified employee pensions (within the meaning of section 408(k)) and simplified retirement accounts (within the meaning of section 408(p)) of a covered expatriate are treated as deferred compensation items and not as specified tax deferred accounts.

Interests in trusts

Grantor trusts

In the case of the portion of any trust for which the covered expatriate is treated as the owner under the grantor trust provisions of the Code, as determined immediately before the expatriation date, the assets held by that portion of the trust are subject to the mark-to-market tax. If a trust that is a grantor trust immediately before the expatriation date subsequently becomes a nongrantor trust, such trust remains a grantor trust for purposes of the provision.

Nongrantor trusts

Special rules apply to trusts with respect to which the covered expatriate is a beneficiary on the day before the expatriation date. The mark-to-market tax does not apply with respect to the portion of any such trust not treated (under the grantor trust provisions of the Code) as owned by a covered expatriate immediately before the expatriation date. Instead, in the case of any direct or indirect distribution from such a portion of a trust ("nongrantor trust") to a covered expatriate, the trustee must deduct and withhold from the distribution an amount equal to 30 percent of the portion of the distribution which would be includible in the gross income of the covered expatriate if the covered expatriate continued to be subject to tax as a citizen or resident of the United States. Such portion of such distribution (that is subject to the 30 percent withholding requirement) is subject to tax under section 871. The covered expatriate is treated as having waived any right to claim any reduction in withholding under any treaty with the United States.

In addition, if the nongrantor trust distributes appreciated property to a covered expatriate, the trust must recognize gain as if the property were sold to the covered expatriate at its fair market value.

If a trust that is a nongrantor trust immediately before the expatriation date subsequently becomes a grantor trust of which a covered expatriate is treated as the owner, directly or indirectly, such conversion is treated under the provision as a distribution to such covered expatriate to the extent of the portion of the trust of which the covered expatriate is treated as the owner.

Special rules

Notwithstanding any other provision of the Code, any period for acquiring property which results in the reduction of gain recognized with respect to property disposed of by the taxpayer terminates on the day before the expatriation date. This rule applies to certain incomplete transactions such as deferred like-kind exchanges and involuntary conversions. In addition, notwithstanding any other provision of the Code, any extension of time for payment of tax ceases to apply on the day before relinquishment of citizenship or termination of residency, and the unpaid portion of such tax becomes due and payable at the time and in the manner prescribed by the Secretary.

For purposes of determining the tax imposed under the mark-to-market tax, property that was held by an individual on the date that such individual first became a resident of the United States (within the meaning of section 7701(b)) is treated as having a basis on such date of not less than the fair market value of such property on such date. An individual may make an irrevocable election not to have this rule apply.

In the case of a domestic trust that becomes a foreign trust due to the expatriation of an individual, the general income tax rules pertaining to transfers by U.S. persons to foreign trusts (i.e., section 684) apply before the rules of the provision.

Regulatory authority

The provision authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the income tax rules of the provision.

Treatment of gifts and bequests from a former citizen or former long-term resident

Under the provision, a special transfer tax applies to certain "covered gifts or bequests" received by a U.S. citizen or resident. A covered gift or bequest is any property acquired (i) by gift directly or indirectly from an individual who is a covered expatriate at the time of such acquisition, or (ii) directly or indirectly by reason of the death of an individual who was a covered expatriate. A covered gift or bequest, however, does not include (i) any property shown as a taxable gift on a timely filed gift tax return by the covered expatriate, and (ii) any property included in the gross estate of the covered expatriate for estate tax purposes and shown on a timely filed estate tax return of the estate of the covered expatriate.

The tax is calculated as the product of (i) the highest marginal rate of tax specified in the table applicable to estate tax (i.e., section 2001(c)) or, if greater, the highest marginal rate of tax specified in the table applicable to gift tax (i.e., section 2502(a)), both as in effect on the date of receipt of the covered gift or bequest; and (ii) the value of the covered gift or bequest.

The tax is imposed upon the recipient of the covered gift or bequest and is imposed on a calendar-year basis. The tax applies to a recipient of a covered gift or bequest only to the extent that the total value of covered gifts and bequests received by such recipient during a calendar year exceeds $10,000. The tax on covered gifts and bequests is reduced by the amount of any gift or estate tax paid to a foreign country with respect to such covered gift or bequest.

Special rules apply to the tax on covered gifts or bequests made to domestic or foreign trusts. In the case of a covered gift or bequest made to a domestic trust, the tax applies as if the trust is a U.S. citizen, and the trust is required to pay the tax. In the case of a covered gift or bequest made to a foreign trust, the tax applies to any distribution from such trust (whether from income or corpus) attributable to such covered gift or bequest to a recipient that is a U.S. citizen or resident, in the same manner as if such distribution were a covered gift or bequest. Such a recipient is entitled to deduct the amount of such tax for income tax purposes to the extent such tax is imposed on the portion of such distribution that is included in the gross income of the recipient. For purposes of these rules, a foreign trust may elect to be treated as a domestic trust. The election may not be revoked without the Secretary's consent.

Coordination with present-law alternative tax regime

Under the provision, the present-law expatriation income tax rules under section 877 generally continue to apply to a covered expatriate whose expatriation or residency termination occurs before, on, or after the date of enactment.

Information reporting

Certain information reporting requirements under the law presently applicable to former citizens and former long-term residents (sec. 6039G) also apply for purposes of the provision.

Effective Date

The provision generally is effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after the date of enactment. However, the portion of the provision relating to covered gifts and bequests is effective for gifts and bequests received from former citizens or former long-term residents (or their estates) on or after the date of enactment, regardless of when the transferor expatriated.

E. Repeal of Provision Regarding Suspension of Interest and Penalties (sec. 505 of the bill and sec. 6404(g) of the Code)

Present Law

In general, interest and penalties accrue during periods for which taxes were unpaid without regard to whether the taxpayer was aware that there was tax due. Prior to amendment by the Small Business and Work Opportunity Tax Act of 2007, the accrual of certain penalties and interest is suspended starting 18 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period. If a tax return is filed before the due date, for purposes of interest suspension it is considered to have been filed on the due date. Interest and penalties resume 21 days after the IRS sends the required notice to the taxpayer. The provision is applied separately with respect to each item or adjustment. The provision does not apply where a taxpayer has self-assessed the tax. The suspension only applies to individuals who file a timely tax return. The provision does not apply to the following: the penalty for failing to pay; any interest, penalty, addition to tax, or additional amount in a case involving fraud; any interest, penalty, addition to tax, or additional amount with respect to any gross misstatement; and any criminal penalty. Generally, the suspension of interest also does not apply to interest accruing with respect to underpayments resulting from listed transactions or undisclosed reportable transactions.

For IRS notices issued after November 25, 2007, the Small Business and Work Opportunity Tax Act of 2007 provides that the accrual of penalties and interest is suspended starting 36 months after the filing of the tax return.[153] Because the general statute of limitations on assessment of tax is 36 months after the filing of a tax return, the effect of the provision in the Small Business and Work Opportunity Tax Act of 2007 is that interest suspension only applies to tax liabilities eligible for suspension which may be assessed more than three years after the filing of the tax return to which the liability relates.

Reasons for Change

As a result of the provision in the Small Business and Work Opportunity Tax Act of 2007, interest suspension only applies in the small number of cases in which the IRS may assess an additional tax more than three years after the filing of the tax return to which such additional tax liability relates. The Committee believes that the rules regarding the accrual of interest on underpayments of tax should be applied, to the extent possible, in a consistent manner. Thus, the Committee believes the suspension of interest and penalties provision should be repealed. The Committee believes this change is appropriate for effective administration of the tax system.

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[153] Pub. L. No. 110-28, sec. 7542 (2007).

Explanation of Provision

The provision repeals the suspension of interest and certain penalties provision. The Small Business and Work Opportunity Tax Act of 2007 provides that the accrual of penalties and interest is suspended starting 36 months after the filing of a tax return. Thus, the effect of the provision is to eliminate interest suspension for liabilities which may be assessed more than three years after the filing of a tax return.

Effective Date

The provision is effective for IRS notices issued after the date which is 6 months after the date of the enactment of the Small Business and Work Opportunity Tax Act of 2007 (November 25, 2007).

F. Unused Merchandise Drawback

1. Unused Merchandise Drawback (section 506 of the bill)

Present law

Section 313(j) of the Tariff Act of 1930 (19 U.S.C. 1313(j)) currently provides for unused merchandise drawback. Unused drawback is permitted if imported merchandise is exported or destroyed within 3 years of import without being used in the United States. Pursuant to section 313(j)(2) of the Tariff Act of 1930 (19 U.S.C. 1313(j)(2)), domestic or imported merchandise that is commercially interchangeable with the imported merchandise may be substituted for the imported merchandise and drawback granted on the export or destruction of the substituted merchandise within the 3-year period beginning on the date of importation. The drawback is limited to 99% of the duty, tax and fee imposed under Federal law on the imported merchandise upon entry or importation.

Reasons for change

Section 313(j)(2) of the Tariff Act of 1930 does not contain a definition of "commercially interchangeable." From late 2001 to May 2007, Customs and Border Protection (CBP) paid drawback claims on wine based on white domestic and imported table wine being commercially interchangeable with relatively valued imported white table wine. Red domestic and imported table wine was also considered to be commercially interchangeable with relatively valued imported red table wine. Relatively valued wine was considered to be wine within a price range of 50%.

CBP informed wine drawback claimants in May 2007 that, effective immediately, the above standard for commercial interchangeability was no longer applicable. CBP did not provide a definitive new standard but stated that the criterion of the varietal wine should have been a determining factor in determining commercial interchangeability.

The new provision carries forward the standard used for commercial interchangeability from 2001 to May 2007, and provides certainty for the filing and processing of unused drawback claims for imported and exported wine.

Explanation of provision

The provision amends section 313(j)(2) of the Tariff Act of 1930, to provide a standard for what is considered to be "commercially interchangeable" for purposes of unused merchandise drawback for wine.

Effective Date

The provision is effective for claims filed for drawback on or after the date of enactment.

TITLE VI – REVENUE PROVISIONS

A. Nonqualified Deferred Compensation From Certain Tax Indifferent Parties

1. Offshore nonqualified deferred compensation (sec. 601 of the bill and new sec. 457A of the Code)

Present Law

In general

Under present law, the determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the person earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine,[154] the provisions of section 83 relating generally to transfers of property in connection with the performance of services, provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)), and the requirements of section 409A.

In general, the time for income inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation generally is includible in income by a cash-basis taxpayer when it is actually or constructively received. If the arrangement is funded, then income is includible for the year in which the individual's rights are transferable or not subject to a substantial risk of forfeiture.

An arrangement generally is considered funded if there has been a transfer of property under section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of section 83.[155] Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor; for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. On the other hand, deferred amounts generally are not includible in income if nonqualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

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[154] See, e.g., *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd, per curiam*, 194 F.2d 541 (6th Cir. 1952); Rev. Rul. 60-31, 1960-1 C.B. 174.

[155] Treas. Reg. sec. 1.83-3(e). This definition, in part, reflects previous IRS rulings on nonqualified deferred compensation.

As discussed above, if the arrangement is unfunded, then the compensation generally is includible in income by a cash-basis taxpayer when it is actually or constructively received under section 451.[156] Income is constructively received when it is credited to a person's account, set apart, or otherwise made available so that it may be drawn on at any time. Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. A requirement to relinquish a valuable right in order to make withdrawals is generally treated as a substantial limitation or restriction.

Prior to the enactment of section 409A, arrangements had developed in an effort to provide employees with security for nonqualified deferred compensation, while still allowing deferral of income inclusion under the constructive receipt doctrine (which applies to unfunded arrangements). One such arrangement is a "rabbi trust." A rabbi trust is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation, except that the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of insolvency or bankruptcy. In the case of a rabbi trust, these terms have been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.[157] As a result, no amount is included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

Section 409A

Reason for enactment

The Congress enacted section 409A[158] because it was concerned that many nonqualified deferred compensation arrangements had developed which allowed improper deferral of income. Executives often used arrangements that allowed deferral of income, but also provided security of future payment and control over amounts deferred. For example, nonqualified deferred compensation arrangements often contained provisions that allowed participants to receive distributions upon request, subject to forfeiture of a minimal amount (i.e., a "haircut" provision). In addition, Congress was aware that since the concept of a rabbi trust was developed, techniques had been used that attempted to protect the assets from creditors despite the terms of the trust. For example, the trust or fund would be located in a foreign jurisdiction, making it difficult or impossible for creditors to reach the assets.

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[156] Treas. Reg. secs. 1.451-1 and 1.451-2.

[157] This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence, the popular name "rabbi trust." Priv. Ltr. Rul. 8113107 (Dec. 31, 1980).

[158] Section 409A was added to the Code by sec. 885 of the American Job Creation Act of 2004, Pub. L. No. 108-357.

Prior to the enactment of section 409A, while the general tax principles governing deferred compensation were well established, the determination whether a particular arrangement effectively allowed deferral of income was generally made on a facts and circumstances basis. There was limited specific guidance with respect to common deferral arrangements. The Congress believed that it was appropriate to provide specific rules regarding whether deferral of income inclusion should be permitted and to provide a clear set of rules that would apply to these arrangements. The Congress believed that certain arrangements that allow participants inappropriate levels of control or access to amounts deferred should not result in deferral of income inclusion. The Congress also believed that certain arrangements, such as offshore trusts, which effectively protect assets from creditors of the employer, should be treated as funded and not result in deferral of income inclusion to the extent the amounts are vested.

General requirements of section 409A

In general.-- Under section 409A, all amounts deferred by a service provider under a nonqualified deferred compensation plan[159] for all taxable years are currently includible in gross income of the service provider to the extent such amounts are not subject to a substantial risk of forfeiture[160] and not previously included in gross income, unless certain requirements are satisfied. If the requirements of section 409A are not satisfied, in addition to current income inclusion, interest at the rate applicable to underpayments of tax plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax.

Section 409A does not limit the amount that may be deferred under a nonqualified deferred compensation plan. The Secretary of the Treasury is authorized to prescribe regulations as are necessary or appropriate to carry out the purposes of section 409A. The Secretary of the Treasury published final regulations under section 409A on April 17, 2007.

Under these regulations, the term "service provider" includes an individual, corporation, subchapter S corporation, partnership, personal service corporation (as defined in section 269A(b)(1)), noncorporate entity that would be a personal service corporation if it were a corporation, or qualified personal service corporation (as defined in section 448(d)(2)) for any taxable year in which such individual or entity accounts for gross income from the performance of services under the cash receipts and disbursements method of accounting.[161] Section 409A does not apply to a service provider that provides significant services to at least two service

[159] A plan includes an agreement or arrangement, including an agreement or arrangement that includes one person. Amounts deferred also include actual or notional earnings.

[160] The rights of a person to compensation are subject to a substantial risk of forfeiture if the person's rights to such compensation are conditioned upon the performance of substantial services by any individual.

[161] Treas. Reg. sec. 1.409A-1(f)(1).

recipients that are not related to each other or the service provider. This exclusion does not apply to a service provider who is an employee or a director of a corporation (or similar position in the case of an entity that is not a corporation).[162] In addition, the exclusion does not apply to an entity that operates as the manager of a hedge fund or private equity fund. This is because the exclusion does not apply to the extent that a service provider provides management services to a service recipient. Management services for this purpose means services that involve the actual or de facto direction or control of the financial or operational aspects of a trade or business of the service recipient or investment management or advisory services provided to a service recipient whose primary trade or business includes the investment of financial assets, such as a hedge fund.[163]

Permissible distribution events.–Under section 409A, distributions from a nonqualified deferred compensation plan may be allowed only upon separation from service (as determined by the Secretary of the Treasury), death, a specified time (or pursuant to a fixed schedule), change in control of a corporation (to the extent provided by the Secretary of the Treasury), occurrence of an unforeseeable emergency, or if the service provider becomes disabled. A nonqualified deferred compensation plan may not allow distributions other than upon the permissible distribution events and, except as provided in regulations by the Secretary of the Treasury, may not permit acceleration of a distribution. In the case of a specified employee who separates from service, distributions may not be made earlier than six months after the date of the separation from service or upon death. Specified employees are key employees[164] of publicly-traded corporations.

Elections.–Section 409A requires that a plan must provide that compensation for services performed during a taxable year may be deferred at the service provider's election only if the election to defer is made no later than the close of the preceding taxable year, or at such other time as provided in Treasury regulations. In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than six months before the end of the service period. The time and form of distributions must be specified at the time of initial deferral. A plan may allow changes in the time and form of distributions subject to certain requirements.

Back-to-back arrangements.–Back-to-back service recipients (i.e., situations under which an entity receives services from a service provider such as an employee, and the entity in turn provides services to a client) that involve back-to-back nonqualified deferred compensation arrangements (i.e., the fees payable by the client are deferred at both the entity level and the employee level) are subject to special rules under section 409A. For example, the final

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[162] Treas. Reg. sec. 1.409A-1(f)(2).

[163] Treas. Reg. sec. 1.409A-1(f)(2)(iv).

[164] Key employees are defined in section 416(i) and generally include officers (limited to 50 employees) having annual compensation greater than $145,000 (for 2007), five percent owners, and one percent owners having annual compensation from the employer greater than $150,000.

regulations generally permit the deferral agreement between the entity and its client to treat as a permissible distribution event those events that are specified as distribution events in the deferral agreement between the entity and its employee. Thus, if separation from employment is a specified distribution event between the entity and the employee, the employee's separation generally is a permissible distribution event for the deferral agreement between the entity and its client.[165]

Offshore funding arrangements.–Section 409A requires current income inclusion in the case of certain offshore funding of nonqualified deferred compensation. Under section 409A, in the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary of the Treasury) for purposes of paying nonqualified deferred compensation, such assets are treated as property transferred in connection with the performance of services under section 83 (whether or not such assets are available to satisfy the claims of general creditors) at the time set aside if such assets (or trust or other arrangement) are located outside of the United States or at the time transferred if such assets (or trust or other arrangement) are subsequently transferred outside of the United States. Any subsequent increases in the value of, or any earnings with respect to, such assets are treated as additional transfers of property.

Interest at the underpayment rate plus one percentage point is imposed on the underpayments of tax that would have occurred had the amounts set aside been includible in income for the taxable year in which first deferred or, if later, the first taxable year not subject to a substantial risk of forfeiture. The amount required to be included in income also is subject to an additional 20-percent tax.

The special funding rule does not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such foreign jurisdiction. The Secretary of the Treasury has authority to exempt arrangements from the provision if the arrangements do not result in an improper deferral of U.S. tax and will not result in assets being effectively beyond the reach of creditors.

Definition of substantial risk of forfeiture

Under the Treasury regulations, compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned upon either the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, provided that the possibility of forfeiture is substantial.[166]

Definition of nonqualified deferred compensation

Under section 409A, a nonqualified deferred compensation plan generally includes any plan that provides for the deferral of compensation other than a qualified employer plan or any

[165] Treas. Reg. sec. 1.409A-3(i)(6).

[166] Treas. Reg. sec. 1.409A-1(d)(1).

bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. A qualified employer plan means a qualified retirement plan, tax-deferred annuity, simplified employee pension, and SIMPLE. A qualified governmental excess benefit arrangement (sec. 415(m)) and an eligible deferred compensation plan (sec. 457(b)) is a qualified employer plan.

The Treasury regulations also provide that certain other types of plans are not considered deferred compensation, and thus are not subject to section 409A. For example, if a service recipient transfers property to a service provider, there is no deferral of compensation merely because the value of the property is not includible in income under section 83 by reason of the property being substantially nonvested.[167] Another exception applies to amounts that are not deferred beyond a short period of time after the amount is no longer subject to a substantial risk of forfeiture.[168] Under this exception, there generally is no deferral for purposes of section 409A if the service provider actually or constructively receives the amount on or before the last day of the applicable 2½ month period. The applicable 2½ month period is the period ending on the later of the 15th day of the third month following the end of: (1) the service provider's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture; or (2) the service recipient's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture.

Special rules apply in the case of stock appreciation rights ("SARs").[169] Under the final Treasury regulations, a SAR is a right to compensation based on the appreciation in value of a specified number of shares of service recipient stock occurring between the date of grant and the date of exercise of such right. The final regulations generally provide that a SAR does not result in a deferral of compensation for purposes of section 409A (and thus is not subject to section 409A) if the compensation payable under the SAR is not greater than the excess of the fair market value of the underlying stock on the date the SAR is exercised over the fair market value of the underlying stock on the date the SAR is granted.[170]

The Treasury regulations provide exclusions from the definition of nonqualified deferred compensation in the case of services performed by individuals who participate in certain foreign plans, including plans covered by an applicable treaty and broad-based foreign retirement plans.[171] In the case of a U.S. citizen or lawful permanent alien, nonqualified deferred compensation plan does not include a broad-based foreign retirement plan, but only with respect to the portion of the plan that provides for nonelective deferral of foreign earned income and subject to limitations on the annual amount deferred under the plan or the annual amount payable

[167] Treas. Reg. sec. 1.409A-1(b)(6).

[168] Treas. Reg. sec. 1.409A-1(b)(4).

[169] Treas. Reg. sec. 1.409A-1(b)(5).

[170] Treas. Reg. sec. 1.409A-1(b)(5)(i)(B).

[171] Treas. Reg. sec. 1.409A-1(a)(3).

under the plan. In general, foreign earned income refers to amounts received by an individual from sources within a foreign country that constitutes earned income attributable to services.

Timing of the service recipient's deduction

Special statutory provisions govern the timing of the deduction for nonqualified deferred compensation, regardless of whether the arrangement covers employees or nonemployees and regardless of whether the arrangement is funded or unfunded.[172] Under these provisions, the amount of nonqualified deferred compensation that is includible in the income of the service provider is deductible by the service recipient for the taxable year in which the amount is includible in the service provider's income.[173] Thus, for example, in the case of an unfunded nonqualified deferred compensation plan, a deduction to the taxable service recipient is deferred until the deferred compensation is actually paid or made available to the service provider.

Section 457

Special income recognition rules apply in the case of a participant in a deferred compensation plan that is sponsored by a State or local government or an organization that is exempt from Federal income tax under section 501(a). Section 457 provides for different income inclusion rules for two basic types of deferred compensation arrangements: (1) arrangements that limit the amount of compensation that may be deferred (generally, $15,500 in 2007) and that meet certain other requirements specified in section 457(b) (referred to as a "section 457(b) plan" or an "eligible deferred compensation plan"); and (2) arrangements that do not satisfy the requirements of section 457(b) (referred to as a "section 457(f) plan" or an "ineligible deferred compensation plan"). Section 457 does not provide a limit on the amount of compensation that may be deferred under a section 457(f) plan.

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[172] Secs. 404(a)(5), (b) and (d) and sec. 83(h).

[173] In the case of a publicly held corporation, no deduction is allowed for a taxable year for remuneration with respect to a covered employee to the extent that the remuneration exceeds $1 million. Code sec. 162(m). The Code defines the term "covered employee" in part by reference to Federal securities law. In light of changes to Federal securities law, the Internal Revenue Service interprets the term covered employee as the principal executive officer of the taxpayer as of the close of the taxable year or the 3 most highly compensated employees of the taxpayer for the taxable year whose compensation must be disclosed to the taxpayer's shareholders (other than the principal executive officer or the principal financial officer). Notice 2007-49, 2007-25 I.R.B. 1429. For purposes of the deduction limit, remuneration generally includes all remuneration for which a deduction is otherwise allowable, although commission-based compensation and certain performance-based compensation are not subject to the limit. Remuneration does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee. Thus, the deduction limitation often does not apply to deferred compensation that is otherwise subject to the deduction limitation (e.g., is not performance-based compensation) because the payment of the compensation is deferred until after termination of employment.

A participant in a section 457(b) plan does not recognize income with respect to the participant's interest in such plan until the time of actual distribution (or, if earlier, the time the participant's interest is made available to the participant, but only in the case of a section 457(b) plan maintained by a tax-exempt sponsor other than a State or local government). In contrast, a participant in a section 457(f) plan must include amounts deferred under such a plan in gross income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation.

Reasons for Change

Under present law, there is a tension in the case of a nonqualified deferred compensation agreement between a service provider and a taxable service recipient. This arises because the timing rule under the Code defers the service recipient's deduction for nonqualified deferred compensation until the taxable year in which such compensation is includible in the service provider's gross income. This tension may limit the amount of compensation that a service recipient is willing to permit a service provider to defer under a nonqualified deferred compensation arrangement. Even where this tension does not limit the amount of compensation that a service recipient is willing to permit a service provider to defer under a nonqualified deferred compensation arrangement, this tension ensures that the cost of allowing this deferral is borne by the service recipient.

Under present law, the ability to defer nonqualified deferred compensation is limited in certain cases in which this tension is not present. Where this tension is not present, the cost of allowing service providers to defer under a nonqualified deferred compensation arrangement is not borne by the service recipient. Instead, this cost is borne by the Treasury. In order to limit the cost to the Treasury, Congress passed special rules limiting deferral in certain situations. Specifically, section 457 provides special rules that limit deferred compensation arrangements sponsored by State and local governments and other tax-exempt entities.

The Committee has become aware of other situations in which the present law tension does not exist. Specifically, foreign corporations that are not subject to a comprehensive income tax and partnerships that are comprised of foreign persons and U.S. tax-exempt entities are indifferent to the timing of deductions for nonqualified deferred compensation. The Committee believes that in such cases additional rules should apply that limit the ability to defer service provider compensation.

Explanation of Provision

Under the provision, any compensation that is deferred under a nonqualified deferred compensation plan of a nonqualified entity is includible in gross income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to such compensation. The provision applies in addition to the requirements of section 409A (or any other provision of the Code or general tax law principle) with respect to nonqualified deferred compensation.

For purposes of the provision, the term nonqualified deferred compensation is defined in the same manner as for purposes of section 409A. As under section 409A, the term nonqualified deferred compensation includes earnings with respect to previously deferred amounts. Under the provision, nonqualified deferred compensation includes any arrangement under which compensation is based on the increase in value of a specified number of equity units of the service recipient. Thus, stock appreciation rights (SARs) are treated as nonqualified deferred compensation under the provision, regardless of the exercise price of the SAR.

The term nonqualified entity includes certain foreign corporations and certain partnerships (either domestic or foreign). A foreign corporation is a nonqualified entity unless substantially all of such income is effectively connected with the conduct of a United States trade or business or is subject to a comprehensive foreign income tax. A partnership is a nonqualified entity unless substantially all of such income is allocated to persons other than foreign persons with respect to whom such income is not subject to a comprehensive income tax and organizations which are exempt from U.S. income tax.

The term comprehensive foreign income tax means with respect to a foreign person, the income tax of a foreign country if (1) such person is eligible for the benefits of a comprehensive income tax treaty between such foreign county and the United States, or (2) such person demonstrates to the satisfaction of the Secretary of the Treasury that such foreign country has a comprehensive income tax. A comprehensive foreign income tax does not include any tax unless the tax includes rules for the deductibility of deferred compensation which are similar to the rules under the Code.

For purposes of the provision, compensation of a service provider is subject to a substantial risk of forfeiture only if such person's right to the compensation is conditioned upon the future performance of substantial services by any person. Thus, compensation is subject to a substantial risk of forfeiture only if entitlement to the compensation is conditioned on the performance of substantial future services and the possibility of forfeiture is substantial. Substantial risk of forfeiture does not include a condition related to a purpose of the compensation (other than future performance of substantial services), regardless of whether the possibility of forfeiture is substantial.

Under the provision, if the amount of any deferred compensation is not ascertainable at the time that such compensation is otherwise required to be taken into income under the provision, the amount is taken into account when such amount becomes ascertainable. In addition, the income tax with respect to such amount is increased by the sum of (1) an interest charge, and (2) an amount equal to 20 percent of such compensation. The interest charge is equal to the interest at the rate applicable to underpayments of tax plus one percentage point imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture.

It is intended that the Secretary of the Treasury issue regulations as to when an amount is unascertainable for purposes of the provision. It is intended that an amount of deferred compensation is unascertainable at the time the amount is no longer subject to a substantial risk of forfeiture if the amount varies depending on the satisfaction of an objective condition. For example, if a deferred amount varies depending on the satisfaction of an objective condition at the time the amount is no longer subject to substantial risk of forfeiture (e.g., 20 percent of the amount is paid if a certain threshold is achieved, 100 percent is paid if a higher threshold is achieved, and 200 percent is paid if a still higher threshold is achieved), the amount deferred is unascertainable.

The Secretary of the Treasury is also authorized to issue such regulations as may be necessary or appropriate to carry out the purposes of the provision, including regulations disregarding a substantial risk of forfeiture as necessary to carry out such purposes.

Under the provision, aggregation rules similar to those that apply under section 409A apply for purposes of determining whether a plan sponsor is a nonqualified entity. It is intended, however, that such aggregation rules are limited by the Secretary to operate in accordance with the purposes of the provision. For example, it is intended that the aggregation rules do not result in the application of the provision to employees of a U.S. subsidiary C corporation that is wholly owned by a nonqualified entity when the U.S. subsidiary sponsors the nonqualified deferred compensation plan in which the employees of the subsidiary participate. This is because the subsidiary is subject to the timing rule with respect to its deduction of its employees' nonqualified deferred compensation.

Effective Date

The provision is effective with respect to amounts deferred which are attributable to services performed after December 31, 2007. In the case of an amount deferred which is attributable to services performed on or before December 31, 2007, to the extent such amount is not includible in gross income in a taxable year beginning before 2017, then such amount is includible in gross income in the later of (1) the last taxable year beginning before 2017, or (2) the taxable year in which there is no substantial risk of forfeiture of the rights to such compensation.

No later than 60 days after date of enactment, the Secretary shall issue guidance providing a limited period of time during which a nonqualified deferred compensation arrangement attributable to services performed on or before December 31, 2007, may, without violating the requirements of section 409A(a), be amended to conform the date of distribution to the date the amounts are required to be included in income.

B. Provisions Related to Certain Investment Partnerships

1. Income of partners for performing investment management services treated as ordinary income received for performance of services (sec. 611 of the bill and new sec. 710 and secs. 856(c), 6662, and 6664 of the Code)

Present Law

Partnership profits interest for services

A profits interest in a partnership is the right to receive future profits in the partnership but does not generally include any right to receive money or other property upon the immediate liquidation of the partnership. The treatment of the receipt of a profits interest in a partnership in exchange for the performance of services has been the subject of controversy. In general, a taxpayer receiving a profits interest for performing services has not been taxable upon the receipt of the partnership interest.[174]

In 1993, the Internal Revenue Service, referring to the results of cases, specifically ruled that the receipt of a partnership profits interests for services generally is not a taxable event for the partnership or the partner.[175] Under the ruling, this treatment does not apply, however, if: (1) the profits interest relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease; (2) within two years of receipt, the partner disposes of the profits interest; or (3) the profits interest is a limited partnership interest in a publicly traded partnership. A more recent ruling[176] clarifies that this result applies provided the service partner takes into income his distributive share of partnership income, and the partnership does not deduct any amount either on grant or on vesting of the profits interest.[177]

By contrast, a partnership capital interest received for services is includable in the partner's income under generally applicable rules relating the receipt of property for the

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[174] Only a handful of cases have ruled on this issue. Though one case required the value to be included currently, where value was easily determined by a sale of the profits interest soon after receipt (*Diamond v. Commissioner*, 56 T. C. (1971), *aff'd* 492 F. 2.2d 286 (7th Cir, 1974)), a more recent case concluded that partnership profits interests were not includable on receipt, because the profits interests were speculative and without fair market value (*Campbell v. Commissioner* (943 F. 2d. 815 (8th Cir. 1991))).

[175] Rev. Proc. 93-27, 1993-2 C.B. 343, citing the *Diamond* and *Campbell* cases, *supra*.

[176] Rev. Proc. 2001-43 (2001-2 C.B. 191).

[177] A similar result would occur under the 'safe harbor" election of proposed regulations regarding the application of section 83 to the compensatory transfer of a partnership interest. REG-105346-03, 70 Fed. Reg. 29675 (May 24, 2005).

performance of services.[178] A partnership capital interest for this purpose is an interest that would entitle the receiving partner to a share of the proceeds if the partnership's assets were sold at fair market value and the proceeds were distributed in liquidation.[179]

Passthrough tax treatment of partnerships

The character of partnership items passes through to the partners, as if the items were realized directly by the partners.[180] Thus, for example, long-term capital gain of the partnership is treated as long-term capital gain in the hands of the partners.

A partner holding a partnership interest includes in income its distributive share (whether or not actually distributed) of partnership items of income and gain, including capital gain eligible for the lower income tax rates. A partner's basis in the partnership interest is increased by any amount of gain thus included and is decreased by losses. These basis adjustments prevent double taxation of partnership income to the partner, preserving the partnership's tax status as a passthrough entity. Amounts distributed to the partner by the partnership are taxed to the extent the amount exceeds the partner's basis in the partnership interest.

Employment tax treatment of partners

As part of the financing for Social Security and Medicare benefits, a tax is imposed on the wages of an individual received with respect to his or her employment under the Federal Insurance Contributions Act ("FICA").[181] A similar tax is imposed on the net earnings from self-employment of an individual under the Self-Employment Contributions Act ("SECA").[182]

The FICA tax has two components. Under the old-age, survivors, and disability insurance component ("OASDI"), the rate of tax is 12.40 percent, half of which is imposed on the employer, and the other half of which is imposed on the employee.[183] The amount of wages subject to this component is capped at $97,500 for 2007. Under the hospital insurance component ("HI"), the rate is 2.90 percent, also split equally between the employer and the employee. The amount of wages subject to the HI component of the tax is not capped. The

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[178] Secs. 61 and 83; Treas. Reg. sec. 1.721-1(b)(1); see *U.S. v. Frazell*, 335 F.2d 487 (5th Cir. 1964), *cert denied*, 380 U.S. 961 (1965).

[179] Rev. Proc. 93-27, 1993-2 C.B. 343.

[180] Section 702.

[181] See Chapter 21 of the Code.

[182] Sec. 1401.

[183] Secs. 3101 and 3111.

wages of individuals employed by a business in any form (for example, a C corporation) generally are subject to the FICA tax.[184]

The SECA tax rate is the combined employer and employee rate for FICA taxes. Under the OASDI component, the rate of tax is 12.40 percent and the amount of earnings subject to this component is capped at $97,500 (for 2007). Under the HI component, the rate is 2.90 percent, and the amount of self-employment income subject to the HI component is not capped.

For SECA tax purposes, net earnings from self-employment means the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the self-employment tax rules.[185] Specified types of income or loss are excluded, such as rentals from real estate in certain circumstances, dividends and interest, and gains or loss from the sale or exchange of a capital asset or from timber, certain minerals, or other property that is neither inventory nor held primarily for sale to customers.

For an individual who is a partner in a partnership, the net earnings from self-employment generally include the partner's distributive share (whether or not distributed) of income or loss from any trade or business carried on by the partnership (excluding specified types of income, such as rents and dividends, as described above). This rule applies to individuals who are general partners. A special rule applies for limited partners of a partnership.[186] In determining a limited partner's net earnings from self-employment, an exclusion is provided for his or her distributive share of partnership income or loss. The exclusion does not apply with respect to guaranteed payments to the limited partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services.

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[184] S corporation shareholders who are employees of the S corporation are subject to FICA taxes. A considerable body of case law has addressed the issue of whether amounts paid to S corporation shareholder-employees are reasonable compensation for services and therefore are wages subject to FICA tax or are properly characterized as another type of income (typically, dividends) and therefore not subject to FICA tax.

[185] For purposes of determining net earnings from self-employment, taxpayers are permitted a deduction from net earnings from self-employment equal to the product of the taxpayer's net earnings (determined without regard to this deduction) and one-half of the sum of the rates for OASDI (12.4 percent) and HI (2.9 percent), i.e., 7.65 percent of net earnings. This deduction reflects the fact that the FICA rates apply to an employee's wages, which do not include FICA taxes paid by the employer, whereas a self-employed individual's net earnings are economically the equivalent of an employee's wages plus the employer share of FICA taxes. The deduction is intended to provide parity between FICA and SECA taxes. In addition, self-employed individuals may deduct one-half of self-employment taxes for income tax purposes (sec. 164(f)).

[186] Sec. 1402(a)(13).

Income tax treatment of publicly traded partnerships

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes (sec. 7704(a)). For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market, or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income (sec. 7704(c)(2)). However, this exception does not apply to any partnership that would be described in section 851(a) if it were a domestic corporation, which includes a corporation registered under the Investment Company Act of 1940 as a management company or unit investment trust.

Qualifying income includes interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber). It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) in the case of partnership, a principal activity of which is the buying and selling of such commodities, futures, options or forward contracts.

The rules generally treating publicly traded partnerships as corporations were enacted in 1987 to address concern about long-term erosion of the corporate tax base. At that time, Congress stated, "[t]o the extent that activities would otherwise be conducted in corporate form, and earnings would be subject to two levels of tax (at the corporate and shareholder levels), the growth of publicly traded partnerships engaged in such activities tends to jeopardize the corporate tax base." (H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1065.) Referring to recent tax law changes affecting corporations, the Congress stated, "[t]hese changes reflect an intent to preserve the corporate level tax. The committee is concerned that the intent of these changes is being circumvented by the growth of publicly traded partnerships that are taking advantage of an unintended opportunity for disincorporation and elective integration of the corporate and shareholder levels of tax." (H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1066.)

Real estate investment trusts (REITs)

A real estate investment trust ("REIT") is an entity that derives most of its income from passive real-estate-related investments. A REIT must satisfy a number of tests on an annual basis that relate to the entity's organizational structure, the source of its income, and the nature of its assets. If an electing entity meets the requirements for REIT status, the portion of its income that is distributed to its investors each year generally is treated as a dividend deductible by the REIT and includible in income by its investors. In this manner, the distributed income of the REIT is not taxed at the entity level. The distributed income is taxed only at the investor level.

A REIT generally is required to distribute 90 percent of its income (other than net capital gain) to its investors before the end of its taxable year.

In order for an entity to qualify as a REIT, at least 95 percent of its gross income generally must be derived from certain passive sources (the "95-percent income test"). In addition, at least 75 percent of its income generally must be from certain real estate sources (the "75-percent income test"), including rents from real property (as defined) and gain from the sale or other disposition of real property. Amounts received as impermissible "tenant services income" are not treated as rents from real property.[187] In general, such amounts are for services rendered to tenants that are not "customarily furnished" in connection with the rental of real property. In addition, at least 75 percent of the value of its total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities, and maximum percentages apply to ownership of other types of securities (the "asset test").

Reasons for Change

The Committee has become aware that some types of service providers in the asset management business have been paying tax at capital gains rates on service income through the use of a partnership profits interest,[188] known as a "carried interest." Because the character of a partnership's income passes through to partners, income from a carried interest may take the form of long-term or short-term capital gain realized by the underlying investment fund as the fund sells off investment assets. In 2007, for individuals generally, the top rate of tax on long-term capital gain is 15 percent, while the top income tax rate on ordinary labor income is 35 percent (plus the applicable employment tax rate).

The Committee held a hearing[189] covering Federal tax issues arising from the use of carried interests in asset management businesses. In these arrangements, the investment fund typically is a partnership. The investors are limited partners that contribute capital to acquire

[187] A REIT is not treated as providing services that produce impermissible tenant services income if such services are provided by an independent contractor from whom the REIT does not derive or receive any income. An independent contractor is defined as a person who does not own, directly or indirectly, more than 35 percent of the shares of the REIT. Also, no more than 35 percent of the total shares of stock of an independent contractor (or of the interests in net assets or net profits, if not a corporation) can be owned directly or indirectly by persons owning 35 percent or more of the interests in the REIT.

[188] A partnership profits interest generally gives the partner a right to receive a percentage of a partnership's profits without an obligation to contribute to partnership capital and without a right to partnership assets on liquidation.

[189] The Ways and Means Committee hearing took place September 6, 2007. See Joint Committee on Taxation, *"Present Law and Analysis Relating to Tax Treatment of Partnership Carried Interests and Related Issues, Part I,"* (JCX-62-07), September 4, 2007, and Joint Committee on Taxation, *"Present Law and Analysis Relating to Tax Treatment of Partnership Carried Interests and Related Issues, Part II,"* (JCX-63-07), September 4, 2007.

fund assets, and the fund manager is the general partner of the investment fund partnership. The general partner is itself a partnership of individuals with investment management expertise. The fund manager receives management fees along with a carried interest.

The Committee believes that in the case of an investment services partnership interest the carried interest arrangement primarily involves the performance of services by individuals whose professional skill generates capital income for investors in the fund. While these individuals' economic interests are aligned with those of the fund investors to the extent their compensation is based on the positive investment yield of the fund, the individuals are nevertheless performing services. Therefore, the income should be taxed as ordinary compensation income for the performance of services.

The Committee believes this result is needed to protect the neutrality of the tax law with respect to income for different types of services, and is necessary to provide fairness in the tax law. The tax rules should not permit investment managers to structure their compensation so it is subject to preferential capital gains rates of 15 percent, and to pay no employment tax on these amounts, while wage-earners who have no such restructuring opportunities are subject to tax on ordinary income up to a top rate of 35 percent, plus employment tax.

The Committee understands that the Internal Revenue Service currently takes the position that the receipt of a partnership profits interest is not generally a taxable event to the partner or to the partnership unless unusual circumstances indicate the interest is easy to value and it is held for a relatively short time. As acknowledged by the Internal Revenue Service in taking this position, however, courts have reasoned that the value of the profits interest for services should be included in income on receipt, but valuation of these interests is often difficult due to factors such as the speculative nature of future business profits. Therefore, efforts to measure the amount of compensation for services by including in income the value of a partnership profits interest received for services at the time of receipt have not been successful.

The Committee bill consequently takes a different approach, the approach of treating net income and gain from an investment services partnership interest as ordinary income for the performance of services except to the extent it is attributable to the partner's invested capital. Capital gains tax treatment will still be available to the extent that gain is attributable to the partner's invested capital.

It is intended that the present-law employment tax rules apply to this income to the same extent they apply to other compensation income. To ensure that the substance of the provision applies regardless of the use of vehicles other than partnerships to seek reduction of tax on compensation income for investment services, the provision also recharacterizes as ordinary income for the performance of services the income or gain with respect to certain other interests, including interests in certain entities other than partnerships, that are held by a person who performs, directly or indirectly, investment management services for the entity. In addition, to strongly ensure compliance with the provision, a 40-percent strict liability penalty applies to underpayments attributable to such techniques to seek to avoid ordinary income tax rates under the provision. It is expected that in enforcement, in coordinating with present-law rules relating to partners and partnerships, and in providing other guidance under the provision, the Treasury

Department will consistently limit opportunities to avoid ordinary income tax on compensation within the scope of the provision.

The income recharacterized as ordinary compensation income under the provision is not treated as qualifying income of a publicly traded partnership, because it is in the nature of compensation (rather than the types of income listed as qualifying income). The effective date of the provision as it applies with respect to publicly traded partnerships is deferred until taxable years beginning after December 31, 2009, to permit compliance with the provision.

Explanation of Provision

Recharacterization as ordinary income for performance of services

The provision generally treats net income from an investment services partnership interest as ordinary income for the performance of services except to the extent it is attributable to the partner's invested capital. Thus, the provision recharacterizes the partner's distributive share of income from the partnership, regardless of whether such income would otherwise be treated as capital gain, dividend income, or any other type of income in the hands of the partner. Such income is taxed at ordinary income rates and is subject to self-employment tax.

Net income means, with respect to an investment services partnership interest, the excess (if any) of (1) all items of income and gain taken into account by the partner with respect to the partnership interest for the partnership taxable year, over (2) all items of deduction and loss taken into account by the partner with respect to the partnership interest for the partnership taxable year.

The provision provides that an investment services partnership interest is a partnership interest held by any person who provides (directly or indirectly) a substantial quantity of certain services to the partnership in the conduct of the trade or business of providing such services. The services are: (1) advising the partnership as to the advisability of investing in, purchasing, or selling any specified asset; (2) managing, acquiring, or disposing of any specified asset; (3) arranging financing with respect to acquiring specified assets; (4) any activity in support of any of the foregoing services.

For this purpose, specified assets means securities (as defined in section 475(c)(2)), real estate, commodities (as defined in section 475(e)(2)), or options or derivative contracts with respect to such securities, real estate, or commodities. A security for this purpose means any (1) share of corporate stock, (2) partnership interest or beneficial ownership interest in a widely held or publicly traded partnership or trust, (3) note, bond, debenture, or other evidence of indebtedness, (4) interest rate, currency, or equity notional principal contract, (5) interest in, or derivative financial instrument in, any such security or any currency (regardless of whether section 1256 applies to the contract), and (6) position that is not such a security and is a hedge with respect to such a security and is clearly identified. A commodity for this purpose means a (1) commodity that is actively traded, (2) notional principal contract with respect to such a commodity, (3) interest in, or derivative financial instrument in, such a commodity, or (4) position that is not such a commodity and is a hedge with respect to such a commodity and is clearly identified.

Exception for invested capital

The provision provides an exception to recharacterization as ordinary income for performance of services in the case of the portion of the partner's distributive share of partnership items with respect to the partner's invested capital. Invested capital means the fair market value at the time of contribution of any money or other property contributed to the partnership. The exception applies provided that the partnership makes reasonable allocation of partnership items between the portion of the partner's distributive share attributable to invested capital and the remaining portion. An allocation is not treated as reasonable if it would result in the allocation of a greater portion of income to invested capital than any other partner not providing services would have been allocated with respect to the same amount of invested capital. The exception to recharacterization also applies to gain or loss attributable to invested capital on disposition of the partnership interest, which is the portion that would have been allocable to invested capital if the partnership had sold all its assets immediately before the disposition.

For this purpose, an investment services partnership interest is not treated as acquired by contribution of invested capital to the extent of any loan or other advance made or guaranteed, directly or indirectly, by any partner or the partnership. For example, if partner A loans partner B funds that partner B contributes to the partnership, the loaned amount is not invested capital of partner B.

In addition, for this purpose, any loan or other advance to the partnership made or guaranteed, directly or indirectly by a partner not providing services to the partnership is treated as invested capital of that partner. Income and loss treated as allocable to invested capital are adjusted accordingly. For example, if investors in a private equity fund that is a partnership contribute capital as debt rather than as equity, while the manager of the fund contributes only equity so that his invested capital appears to be a large percentage of the total equity contributed, the provision treats the partnership debt to the investors as the investors' invested capital. The percentage of total invested capital that is attributable to the fund manager in this example is determined taking into account this debt as well as the equity contributed to the fund, so the manager's invested capital is a smaller percentage of total invested capital than if only equity contributions were taken into account.

Losses, dispositions, and partnership distributions

The provision provides rules for the treatment of losses with respect to an investment services partnership interest, as well as for disposition of all or a portion of such a partnership interest, and distributions of partnership property with respect to such a partnership interest.

Consistently with the general rule providing that net income with respect to such a partnership interest is ordinary income for the performance of services, the provision provides that net loss with respect to such a partnership interest (to the extent not disallowed) generally is treated as ordinary loss. For this purpose, net loss means, with respect to an investment services partnership interest, the excess (if any) of (1) all items of deduction and loss taken into account by the partner with respect to the partnership interest for the partnership taxable year, over (2) all items of income and gain taken into account by the partner with respect to the partnership interest for the partnership taxable year. The net loss is allowed for a partnership taxable year, however, only to the extent that the loss does not exceed the excess (if any) of (1) aggregate net income with respect to the partnership interest for prior partnership taxable years, over (2) the aggregate net loss with respect to the partnership interest not disallowed for prior partnership years. Any net loss that is not allowed for the partnership taxable year is carried forward to the next partnership taxable year. Notwithstanding the present-law rule that the basis of a partnership interest generally is reduced by the partner's distributive share of partnership losses and deductions (sec. 705(a)(2)), the provision provides that no adjustment is made to the basis of a partnership interest on account of a net loss that is not allowed for the partnership taxable year. When any such net loss that is carried forward is allowed in a subsequent year, the adjustment is made to the basis of the partnership interest.

Net loss with respect to an investment services partnership interest that was acquired by purchase, however, is not treated as ordinary, to the extent of net loss not exceeding the excess of (1) the basis of the interest immediately after the purchase, over (2) the aggregate net loss not treated as ordinary under this rule in prior taxable years. Such net loss is not taken into account in determining the amount of net income that is treated as ordinary under the provision.

On the disposition of an investment services partnership interest, gain is treated as ordinary income for the performance of services, notwithstanding the present-law rule that gain or loss from the disposition of a partnership interest generally is considered as capital gain or loss (sec. 741; except ordinary treatment applies to the extent attributable to inventory and unrealized receivables, sec. 751). Loss on the disposition of an investment services partnership interest is treated as ordinary loss, but only to the extent of the amount by which aggregate net income previously treated as ordinary exceeds aggregate net loss previously allowed as ordinary under the provision. The amount of net loss that otherwise would have reduced the basis of the investment services partnership interest is disregarded for purposes of the provision, in the event of any disposition of the interest.

On the distribution of appreciated property by a partnership to a partner with respect to an investment services partnership interest, the present-law rule providing that no gain or loss generally is recognized to a partnership on a distribution to a partner of property or money does not apply. Rather, the partnership recognizes gain as if the partnership had sold the property at its fair market value at the time of the distribution. For this purpose, appreciated property means property with respect to which gain would be realized if sold by the partnership at the time of distribution.

In applying the present-law rules relating to ordinary income treatment of amounts attributable to unrealized receivables and inventory items on sale or exchange of a partnership interest (sec. 751(a)), an investment services partnership interest is treated as an inventory item of the partnership. Thus, for example, upon the sale or exchange of an interest in a partnership that in turn holds an investment services partnership interest, amounts received by the transferor partner that are attributable to the investment services partnership interest are considered as ordinary income.

Other entities

The provision also recharacterizes as ordinary income for the performance of services the income or gain with respect to certain other interests, including interests in certain entities other than partnerships, that are held by a person who performs, directly or indirectly, investment management services for the entity.

This rule applies if (1) a person performs (directly or indirectly) investment management services for any entity, (2) the person holds a disqualified interest with respect to the entity, and (3) the value of the interest (or payments thereunder) is substantially related to the amount of realized or unrealized income or gain from the assets with respect to which the investment management services are performed. In this case, any income or gain with respect to the interest is treated as ordinary income for the performance of services. Rules similar to the exception for a partner's invested capital apply for this purpose. For this purpose, a disqualified interest in an entity means (1) any interest other than debt, (2) convertible or contingent debt, (3) an option or other right to acquire either of the foregoing, or (4) a derivative instrument entered into (directly or indirectly) with the entity or an investor in the entity. A disqualified interest does not include a partnership interest. A disqualified interest also does not include stock in a taxable corporation, which for this purpose means either a domestic C corporation or a foreign corporation that is subject to a comprehensive foreign income tax. Under this rule, a comprehensive income tax has the meaning set forth in section 457A(d)(4): the income tax of a foreign country if the foreign corporation is eligible for the benefits of a comprehensive income tax treaty between that country and the U.S., or if the corporation demonstrates to the satisfaction of the Treasury Secretary that the foreign country has a comprehensive income tax.

For example, if a hedge fund manager holds stock of a Cayman Islands corporation that in turn is a partner in a hedge fund partnership, the manager performs investment management services for the hedge fund, and the value of the stock (or dividends) is substantially related to the growth and income in hedge fund assets for which the manager provides investment management services, then gain in the value of the stock, and dividends, are treated as ordinary income for the performance of services. The fact that the services are performed for the hedge fund, rather than directly for the Cayman Islands corporation in which the manager has a disqualified interest, does not change this result under the provision. Thus, the gain is not eligible for the capital gain tax rate, the dividend is not eligible for the special rate on qualified dividends, but rather, are subject to tax at ordinary rates as income from the performance of services. The income is treated as net earnings from self-employment for purposes of the self-employment tax of the individual who performs the services. Though the amounts received may exceed the cap (imposed by reason of section 1402(b)) on the old-age, survivors, and disability insurance portion of the self-employment tax, the hospital insurance portion of the self-employment tax is not capped, and applies to the income.

Underpayment penalty

The provision provides that the accuracy-related penalty under section 6662 on underpayments applies to underpayments attributable the failure to comply with section 710(d) (relating to the treatment of income in connection with investment management services unrelated to partnership interests) or the regulations under section 710 preventing the avoidance of the purposes of section 710. The penalty rate is 40 percent. The present-law reasonable cause exception of section 6664 does not apply with respect to these underpayments, resulting in an automatic penalty.

Self-employment tax treatment

Under the provision, net income from an investment services partnership interest is subject to self-employment tax. Net income from an investment services partnership interest is derived from the performance by a person of a substantial quantity of services to the partnership in the course of the active conduct of a trade or business. This income falls within the definition of net earnings from self-employment, which generally includes a partner's distributive share (whether or not distributed) of income or loss from any trade or business carried on by the partnership (sec. 1402(a)), with certain exclusions. Because net income from an investment services partnership is treated as ordinary income for the performance of services, the present-law exception for gain or loss from the sale or exchange of a capital asset does not apply, even though the net income from the investment service partnership interest might otherwise be characterized as capital gain. The provision also provides that, in the case of a limited partner, the present-law exclusion for limited partners does not apply to any income treated as ordinary income from an investment services partnership interest that is received by an individual who provides a substantial quantity of the specified services.

Rules relating to REITs and publicly traded partnerships

In the case of a REIT to which income and asset limitations apply under present law (sec. 856(c)(2), (3) and (4)), these income and asset tests are applied without regard to the provision. Thus, a REIT may continue to satisfy the income and asset limitations without regard to the provision.

Under the provision, a publicly traded partnership, more than 10 percent of whose gross income consists of net income from an investment services partnership interest, generally is treated as a corporation for Federal tax purposes under section 7704. The present-law exception to corporate treatment for a publicly traded partnership, 90 percent or more of whose gross income is qualifying income within the meaning of section 7704(c)(2), does not apply, because net income from an investment services partnership interest is not qualifying income within the meaning of section 7704(c)(2).

The provision provides a special rule for certain partnerships that are owned by publicly traded REITs and that meet specific requirements, however. Under the special rule, the recharacterization of partnership income as ordinary income for the performance of services does not apply, provided the following requirements are met. The requirements are: (1) the partnership is treated as publicly traded (under section 7704) solely because interests in the partnership are convertible into interests in a publicly traded REIT; (2) 50 percent or more of the capital and profits interests of the partnership are owned, directly or indirectly, at all times during the taxable year, by the REIT (taking into account attribution rules under section 267(c)); and (3) the partnership itself satisfies the REIT income and asset limitations (secs. 856(c)(2), (3), and (4), applied without regard to this provision). Thus, for example, this special rule provides that a partnership is not treated as a corporation under section 7704, in an "upreit" structure in which a publicly traded REIT owns more than 50 percent of the capital and profits interests of the partnership, partnership interests held by persons other than the REIT are convertible into publicly traded REIT stock, and the partnership itself meets the income and asset limitations of the REIT rules (secs. 856(c)(2), (3) and (4)). For this purpose, if the partnership interest may be put to the REIT or the partnership for REIT stock, it is considered convertible into interests of the publicly traded REIT. It is not intended that convertibility of partnership interests into a class of publicly traded REIT stock that tracks the performance of particular partnership assets (such as assets of a type that, if held in excess, would cause the REIT asset or income limitations not to be satisfied), or performance of the partnership assets generally, satisfies this special rule; rather, it is intended that such a partnership does not meet the requirements of this special rule.

Regulatory authority

The Treasury department shall prescribe such regulations as are necessary or appropriate to carry out the purpose of the provision, including regulations to prevent the avoidance of the purposes of the provision and regulations to coordinate the provision with other rules of subchapter K of the Code (relating to partnerships).

Effective Date

The provision is effective generally for taxable years ending after November 1, 2007.

In the case of a partnership taxable year that includes that date, the amount of net income of a partner that is recharacterized as ordinary income for the performance of services under the provision is limited to the lesser of (1) net income for the entire partnership taxable year, or (2) net income determined by taking into account only items attributable to the part of the taxable year after that date.

The provision is effective for dispositions of partnership interests, and partnership distributions, after that date.

The provision relating to income or gain with respect to interests in certain entities other than partnerships that are held by a person who performs, directly or indirectly, investment management services for the entity takes effect on November 1, 2007.

For purposes of applying the rules relating to publicly traded partnerships (section 7704), the provision applies to taxable years beginning after December 31, 2009.

2. Provide that certain indebtedness incurred by a partnership in acquiring qualified securities or commodities is not treated as acquisition indebtedness for purposes of the unrelated debt-financed income rules (sec. 612 of the bill and sec. 514 of the Code)

Present Law

Unrelated business income tax

In general, an organization that otherwise is exempt from Federal income tax is taxed on income from a trade or business regularly carried on that is not substantially related to the organization's exempt purposes.[190] Most exempt organizations are subject to the unrelated business income tax.[191]

Certain types of income are specifically exempt from the unrelated business income tax. These items include, among others, dividends, interest, royalties, and certain rents, unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[192] Organizations liable for tax on unrelated business taxable income ("UBTI") may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

Special rules apply in the case of an exempt organization that owns a partnership interest in a partnership that holds UBTI-producing property. An exempt organization's share of partnership income that is derived from the property generally is taxed as UBTI unless an exception provides otherwise.[193]

Debt-financed property

In general

In general, income of a tax-exempt organization that is produced by debt-financed property is treated as unrelated business income in proportion to the acquisition indebtedness on the income-producing property. Special rules apply in the case of an exempt organization that owns an interest in a partnership (or a pass-through entity taxed as a partnership) that holds debt-financed property.[194] In general, in such cases, if the partnership incurs acquisition indebtedness with respect to property that, if held directly by the exempt organization, would not qualify for an exception from the debt-financed property rules, the receipt of income by the exempt organization with respect to such property may result in recognition of unrelated debt-finance income.

Acquisition indebtedness generally means the amount of unpaid indebtedness incurred by an organization to acquire or improve the property and indebtedness that would not have been incurred but for the acquisition or improvement of the property.[195] Acquisition indebtedness

[190] Secs. 511-514.

[191] Organizations subject to the unrelated business income tax include all organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts), qualified pension, profit-sharing, and stock bonus plans described in section 401(a), and certain State colleges and universities. Sec. 511(a)(2).

[192] Sec. 512(b).

[193] Sec. 512(c).

[194] Sec. 512(c).

[195] Sec. 514(c)(1).

does not include, however, (1) certain indebtedness incurred in the performance or exercise of a purpose or function constituting the basis of the organization's exemption, (2) obligations to pay certain types of annuities, (3) an obligation, to the extent it is insured by the Federal Housing Administration, to finance the purchase, rehabilitation, or construction of housing for low and moderate income persons, or (4) indebtedness incurred by a qualified organization to acquire or improve real property (the "real property exception").[196]

Exception for debt-financed real property investments by qualified organizations

For purposes of the real property exception, a qualified organization is: (1) an educational organization described in section 170(b)(1)(A)(ii)[197] and its affiliated supporting organizations; (2) a qualified trust described in section 401(a) (hereinafter "pension funds"); (3) a title holding company described in section 501(c)(25) (insofar as it holds shares of organizations described in (1) or (2)[198]); or (4) a retirement income account described in section 403(b)(9).[199] To qualify for the real property exception, an acquisition or improvement by the qualified organization must meet several requirements. These include: (1) a requirement generally that the price of the property is a fixed amount determined as of the date of the acquisition or completion of the improvement; (2) restrictions against payment of the indebtedness of the arrangement being dependent upon the revenue, income, or profits derived from the property; (3) restrictions concerning sale-leaseback arrangements; and (4) in general, a prohibition against seller financing.[200]

Additional requirements must be met for the real property exception to apply where the real property is held by a partnership in which a qualified organization is a partner. To qualify for the real property exception, the partnership must meet all of the above-described general requirements and must meet one of the following three requirements: (1) all of the partners of the partnership are qualified organizations; (2) each allocation to a partner of the partnership which is a qualified organization is a qualified allocation (within the meaning of section 168(h)(6)); or (3) the partnership satisfies a rule prohibiting disproportionate allocations.[201]

The disproportionate allocation rule requires two things: first, that the organization satisfy what commonly is referred to as the "fractions rule," and second, that each allocation with

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[196] Sec. 514(c).

[197] This Code section generally describes an educational organization that operates as a school (i.e., "an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on").

[198] Sec. 514(c)(9)(C) & (F).

[199] Sec. 514(c)(9)(C).

[200] Sec. 514(c)(9)(B)(i)-(v).

[201] Sec. 514(c)(9)(B)(vi) & (E).

respect to the partnership have substantial economic effect within the meaning of section 704(b)(2).[202] Under the fractions rule, the allocation of items to any partner that is a qualified organization cannot result in such partner having a share of the overall partnership income for any taxable year greater than such partner's share of overall partnership loss for the taxable year for which such partner's loss share will be the smallest.[203] A partnership generally must satisfy the fractions rule on an actual basis and on a prospective basis for each taxable year of the partnership in which it holds debt-financed property and has at least one partner that is a qualified organization.[204] The fractions rule generally is intended to prevent the shifting of disproportionate income or gains to tax-exempt partners of the partnership or the shifting of disproportionate deductions, losses, or credits to taxable partners.

Reasons for Change

The Committee believes the present-law debt-financed property rules create an incentive for universities, pension funds, and other tax-exempt organizations to invest in investment partnerships that hold debt-financed securities and commodities indirectly through "blocker" corporations established in foreign tax-haven jurisdictions. Such use of offshore blocker corporations may allow exempt organizations to avoid attribution of debt incurred by the investment partnership to the exempt organization and thereby to avoid application of the debt-financed property rules. By eliminating the incentive to invest through blocker corporations established in tax haven jurisdictions where an exempt organization is a partner with limited liability in an investment partnership, the Committee believes that such organizations will be more likely to invest directly in investment partnerships and in many cases will eliminate the use of offshore blocker corporations. In addition, the Committee believes that allowing pension funds, universities, and other exempt organizations to invest directly in certain investment partnerships domestically would reduce transaction costs and increase investment returns.

Description of Provision

In the case of an organization that is a partner with limited liability with respect to a partnership, the provision provides that indebtedness incurred or continued by such partnership in purchasing or carrying any qualified security or commodity is not treated as acquisition indebtedness for purposes of the debt-financed property rules. The term qualified security or commodity means: (1) any security (as defined in section 475(c)(2), with the exception of certain contracts to which section 1256 applies);[205] (2) any commodity (as defined in section

[202] Sec. 514(c)(9)(E)(i).

[203] Sec. 514(c)(9)(E)(i)(I).

[204] Treas. Reg. sec. 1.514(c)-2(b)(2)(i).

[205] This generally includes any (1) share of stock in a corporation; (2) partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; (3) note, bond, debenture, or other evidence of indebtedness; (4) interest rate, currency, or equity notional principal contract; (5) evidence of an interest in, or a derivative financial instrument in any security described in (1), (2), (3) or

475(e)(2));[206] or (3) any option or derivative contract with respect to a security or commodity described in (1) or (2). Similar rules apply in the case of tiered partnerships and other flow-through entities. It is intended that, for purposes of the provision, an organization is treated as a partner with limited liability if its share of the liabilities of the partnership is no greater than the amount of its capital in the partnership.

The provision authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the provision, including regulations to prevent abuse of the provision.

Effective Date

The provision is effective for taxable years beginning after the date of enactment.

3. Application of section 1239 to partnership interests and tax-sharing agreements (sec. 613 of the bill and sec. 1239 of the Code)

Present Law

If property is sold or exchanged between related persons, directly or indirectly, the transferor's gain is treated as ordinary income if the property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation.[207] Such property includes property subject to the allowance for amortization of intangibles under section 197.[208]

The definition of related persons for this purpose includes persons that are related under a 50-percent value test, using specified constructive ownership attribution rules.[209]

In some situations, taxpayers have transferred amortizable intangibles or other depreciable property to a transferee that may not be within the definition of a related party under section 1239, but in connection with the transfer the parties have contractually agreed, under a tax-sharing arrangement, that the transferor is entitled to a percentage of the tax benefits of depreciation or amortization in the hands of the transferee.

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(4), or any currency, including any option, forward contract, short position, and any similar financial instrument in such security or currency; or (6) certain hedges with respect to a security.

[206] This generally includes (1) any commodity which is actively traded; (2) any notional principal contract with respect to a commodity described in (1); (3) any evidence of an interest in, or a derivative instrument in, any commodity described in (1) or (2), including any option, forward contract, futures contract, short position, and any similar instrument in such a commodity; and (4) certain hedges with respect to a commodity.

[207] Sec. 1239.

[208] Sec. 197(f)(7).

[209] Sec. 1239(b).

If a partner transfers an interest in a partnership, the amount of money, or the fair market value of property, received by the transferor partner in exchange for all or a part of his interest in the partnership attributable to unrealized receivables or inventory items of the partnership is considered an amount realized from the sale or exchange of property other than a capital asset. Section 751(d) defines inventory items for this purpose to include any property which, on sale or exchange by the partnership, would be considered property other than a capital asset (and other than property described in section 1231),[210] and also any other property held by the partnership which, if held by the selling partner would be considered property other than such property. Section 64 provides that any gain from the sale or exchange of property which is "treated or considered as 'ordinary income' is treated as "gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b)."[211] If a partner transfers a partnership interest to a related party within the meaning of section 1239 and the partnership owns depreciable property, taxpayers might take the position that the application of section 64 and section 1239 to section 751 is unclear, or that the depreciable property was not transferred "directly or indirectly" to the related party within the meaning of section 1239.[212]

Reasons for Change

The Committee believes that taxpayers should not obtain capital gain treatment for the transfer of depreciable property (including intangibles amortizable under section 197) while retaining an interest in the tax benefits of the depreciation, which may be measured by reference to a higher, ordinary income tax rate of the transferee.

The Committee also believes that the rules of section 1239 should apply where depreciable property (including intangibles amortizable under section 197) is indirectly transferred to a related party through the transfer of a partnership interest.

Explanation of Provision

Under the provision, regardless of whether any other relationship exists between the transferor and transferee, a transferor is related to a transferee for purposes of section 1239 if there is a tax sharing agreement with respect to any sale or exchange. A tax sharing agreement for this purpose means any agreement that provides for the payment to the transferor of any amount that is determined by reference to any portion of the tax benefit realized by the transferee

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[210] Property described in section 1231 is, generally, property used in the trade or business subject to the allowance for depreciation and held for more than one year. Sec.1231(b). Certain other property is also included.

[211] Sec. 64.

[212] See, e.g., McKee, Nelson, and Whitmire, *Federal Taxation of Partnerships and Partners,* (Fourth Ed. 2007) at par. 17.04[2] (see n. 138) and at par. 18.02[4] (see n. 36).

with respect to the depreciation (or amortization) of the property directly or indirectly transferred.[213]

Under the provision, gain recognized by the transferor of a partnership interest to a related party under section 1239 is treated as ordinary income to the extent attributable to unrealized appreciation in property which is of a character subject to depreciation. As under present law, such property includes intangible property which is of a character subject to amortization under section 197.

In the case of a transfer of a partnership interest, the provision applies with respect to any agreement with respect to depreciation or amortization realized with respect to property transferred directly or indirectly in connection with the transfer of the partnership interest. As one example, if a transferor transfers an interest in a partnership, and is entitled to receive the benefits of any tax sharing agreement with respect to property held directly or indirectly by that partnership, then the transferor's gain on transfer of the partnership interest is ordinary income to the extent attributable to such property.

No inference is intended as to the treatment under present law of any transfer subject to the provision.

Effective Date

The provision is effective with respect to sales or exchanges after the date of enactment. However, the provision shall not apply to any sale or exchange pursuant to a written binding contract which includes a tax sharing agreement and which is in effect on November 1, 2007 and not modified thereafter in any material respect.

[213] The provision is not intended to apply to an outright sale of assets between otherwise unrelated parties in which the fixed sales price is negotiated to be higher because of the anticipated tax benefits that will be enjoyed by the transferee. However, in such a situation, if there is also a tax sharing agreement that returns to the transferor any portion of the benefits of deprecation or amortization realized by the transferee, notwithstanding the basic form of the transaction as a transfer of all the benefits to the transferee, then the parties will be treated as related for purposes of the provision.

C. Other Provisions

1. Delay Implementation of Worldwide Interest Allocation (sec. 621 of the bill and sec. 864(f) of the Code)

Present Law

In general

In order 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.[214] 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.[215] For example, both definitions generally

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

[215] One such exception is that the affiliated group for interest allocation purposes includes section 936 corporations that are excluded from the consolidated group.

exclude all foreign corporations from the affiliated group. Thus, while debt generally is 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" (Treas. Reg. sec. 1.861-11T(d)(4)). These include 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 (sec. 864(e)(5)(C)). 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 (sec. 864(e)(5)(D)).

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")[216] 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 by the ratio which the foreign assets of the worldwide affiliated group bears to the total assets of

[216] Pub. L. No. 108-357, sec. 401 (2004).

the worldwide affiliated group,[217] 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.[218]

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,[219] 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.

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, 2008, 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. Once made, the election applies to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election was made and all subsequent taxable years, unless revoked with the consent of the Secretary of the Treasury.

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 provides 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

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[217] 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.

[218] 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.

[219] 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.

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.[220] 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.

The common parent of the pre-election worldwide affiliated group must make the election for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group includes a financial corporation. Once made, the election applies to the financial institution group for the taxable year and all subsequent taxable years. 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 under AJCA

The worldwide interest allocation rules are effective for taxable years beginning after December 31, 2008.

Reasons for Change

The committee acknowledges that the worldwide interest allocation rules of AJCA were added to the Code in 2004, on a delayed effective date basis, as one of a number of changes to the Code's treatment of international investment and cross-border activity of U.S. taxpayers. The committee also recognizes that the Code's rules governing cross-border activity of U.S. taxpayers are exceedingly complex, and the Committee is concerned that certain such international-related provisions of the Code, particularly in their interaction with other such provisions, can produce unintended consequences and may create unintended incentives for economically inefficient behavior by taxpayers seeking to minimize their overall global tax liability. Accordingly, the committee believes that it is desirable to delay implementation of the worldwide interest allocation rules of AJCA to provide further time to comprehensively review the Code's current approach to the taxation of cross-border activity of U.S. taxpayers.

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

Explanation of Provision

The proposal delays by nine years the implementation of the worldwide interest allocation rules added by AJCA. Thus, the worldwide interest allocation rules are effective for taxable years beginning after December 31, 2017.

Effective Date

The provision is effective on the date of enactment.

2. Broker reporting of customer's basis in securities transactions (sec. 622 of the bill and sec. 6045 of the Code)

Present Law

In general

Gain or loss generally is recognized for Federal income tax purposes on realization of that gain or loss (for example, through the sale of property giving rise to the gain or loss). The taxpayer's gain or loss on a disposition of property is the difference between the amount realized and the adjusted basis.[221]

To compute adjusted basis, a taxpayer must first determine the property's unadjusted or original basis and then make adjustments prescribed by the Code.[222] The original basis of property is its cost, except as otherwise prescribed by the Code (for example, in the case of property acquired by gift or bequest or in a tax-free exchange). Once determined, the taxpayer's original basis generally is adjusted downward to take account of depreciation or amortization, and generally is adjusted upward to reflect income and gain inclusions or capital outlays with respect to the property.

Basis computation rules

If a taxpayer has acquired stock in a corporation on different dates or at different prices and sells or transfers some of the shares of that stock, and the lot from which the stock is sold or transferred is not adequately identified, the shares deemed sold are the earliest acquired shares (the "first-in-first-out rule").[223] If a taxpayer makes an adequate identification of shares of stock that it sells, the shares of stock treated as sold are the shares that have been identified.[224] A taxpayer who owns shares in a regulated investment company ("RIC") generally is permitted to

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[221] Sec. 1001.

[222] Sec. 1016.

[223] Treas. Reg. sec. 1.1012-1(c)(1).

[224] Treas. Reg. sec. 1.1012-1(c).

elect, in lieu of the specific identification or first-in-first-out methods, to determine the basis of RIC shares sold under one of two average-cost-basis methods described in Treasury regulations.[225]

Information reporting

Present law imposes information reporting requirements on participants in certain transactions. Under these requirements, information is generally reported to the IRS and furnished to taxpayers. These requirements are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether taxpayers' tax returns are correct and complete. For example, every person engaged in a trade or business generally is required to file information returns for each calendar year for payments of $600 or more made in the course of the payor's trade or business.[226]

Section 6045(a) requires brokers to file with the IRS annual information returns showing the gross proceeds realized by customers from various sale transactions. The Secretary is authorized to require brokers to report additional information related to customers.[227] Brokers are required to furnish to every customer information statements with the same gross proceeds information that is included in the returns filed with the IRS for that customer.[228] These information statements are required to be furnished by January 31 of the year following the calendar year for which the return under section 6045(a) is required to be filed.[229]

A person who is required to file information returns but who fails to do so by the due date for the returns, includes on the returns incorrect information, or files incomplete returns generally is subject to a penalty of $50 for each return with respect to which such a failure occurs, up to a maximum of $250,000 in any calendar year.[230] Similar penalties, with a $100,000 calendar year maximum, apply to failures to furnish correct information statements to recipients of payments for which information reporting is required.[231]

Present law does not require information reporting with respect to a taxpayer's basis in property but does impose an obligation to keep records, as described below.

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[225] Treas. Reg. sec. 1.1012-1(e).

[226] Sec. 6041(a).

[227] Sec. 6045(a).

[228] Sec. 6045(b).

[229] Id.

[230] Sec. 6721.

[231] Sec. 6722.

Basis recordkeeping requirements

Taxpayers are required to "keep such records . . . as the Secretary may from time to time prescribe."[232] Treasury regulations impose recordkeeping requirements on any person required to file information returns.[233]

Treasury regulations provide that donors and donees should keep records that are relevant in determining a donee's basis in property.[234] IRS Publication 552 states that a taxpayer should keep basis records for property until the period of limitations expires for the year in which the taxpayer disposes of the property.

Reasons for Change

The Committee believes that there may be significant underreporting of capital gain income as a result of misreporting of basis. Requiring brokers to report basis to the IRS and taxpayers may reduce capital gain underreporting: When coupled with the present-law requirement to report gross proceeds, mandatory basis reporting will give both taxpayers and the IRS information needed to compute gain (or loss) from securities sales. The Committee, however, understands that imposing basis reporting requirements in all circumstances in which gross proceeds reporting is mandatory under present law would create significant costs and other difficulties for brokers. Consequently, the provision's reporting requirements include certain significant limitations, and the Secretary has broad discretion to provide rules to implement (and, if it deems it appropriate, to broaden) those requirements. The provision also includes rules -- such as mandatory broker-to-broker reporting and issuer reporting of certain organizational actions -- intended to facilitate accurate reporting of tax basis.

Explanation of Provision

In general

Under the provision, every broker that is required to file a return under section 6045(a) reporting the gross proceeds from the sale of a covered security must include in the return the (1) customer's adjusted basis in the security and (2) whether any gain or loss with respect to the security is long-term or short-term (within the meaning of section 1222).

Covered securities

A covered security is any specified security acquired on or after an applicable date if the security was (1) acquired through a transaction in the account in which the security is held or (2) was transferred to that account from an account in which the security was a covered security, but

[232] Sec. 6001.

[233] Treas. Reg. sec. 1.6001-1(a).

[234] Treas. Reg. sec. 1.1015-1(g).

only if the transferee broker received a statement under section 6045A (described below) with respect to the transfer. Under this rule, securities acquired by gift or inheritance are not covered securities.

A specified security is any share of stock in a corporation (including stock of a regulated investment company); any note, bond, debenture, or other evidence of indebtedness; any commodity or a contract or a derivative with respect to the commodity if the Secretary determines that adjusted basis reporting is appropriate; and any other financial instrument with respect to which the Secretary determines that adjusted basis reporting is appropriate.

For stock in a corporation (including in a regulated investment company), the applicable date generally is January 1, 2009. Open-end funds are permitted to elect to treat as a covered security any stock in the fund acquired before January 1, 2009. This election is described below.

For any specified security other than stock in a corporation, the applicable date is January 1, 2011 or a later date determined by the Secretary.

<u>Computation of adjusted basis</u>

The customer's adjusted basis required to be reported to the IRS is determined under the following rules. The adjusted basis of stock in a corporation other than an open-end fund is determined under the first-in, first-out method (described in Treasury regulations under section 1012) unless the customer notifies the broker by means of making an adequate identification (under the rules of section 1012 for specific identification) of the stock sold or transferred. The adjusted basis of stock in an open-end fund acquired before January 1, 2011 is determined in accordance with any permitted method under section 1012 (that is, the first-in, first-out method, the average cost method, or the specific identification method). A broker's basis computation method used for open-end stock held in one account with that broker may differ from the basis computation method used for open-end stock held in another account with that broker. The adjusted basis of stock in an open-end fund acquired on or after January 1, 2011 is determined in accordance with the broker's default method (under section 1012) unless the customer notifies the broker that the customer elects another method permitted by section 1012. This notification is made separately for each account in which open-end stock is held and, once made, applies to all open-end stock held in the account. The adjusted basis of any covered security other than stock is determined under the applicable rules provided in section 1012.

An open-end fund is a regulated investment company that offers for sale or has outstanding any redeemable security of which it is the issuer and the shares of which are not traded on an established securities exchange. A mutual fund the stock of which is priced daily and is acquired from the fund is an open-end fund. So-called exchange traded funds, funds in which there is intra-day pricing and in which shares may be purchased on an exchange (rather than from the funds directly) are not open-end funds.

For any sale, exchange, or other disposition of a specified security after the applicable date (defined previously), the provision modifies section 1012 so that the conventions prescribed by regulations under that section for determining adjusted basis (the first-in, first-out, specific identification, and average cost conventions) apply on an account-by-account basis. Under this rule, for example, if a customer holds shares of the same specified security in accounts with different brokers, each broker makes its adjusted basis determinations by reference only to the shares held in the account with that broker. Unless the election described next applies, stock in an open-end fund acquired before January 1, 2009 is treated as a separate account. A consequence of this rule is that if adjusted basis is being determined using the average cost convention, average cost is computed without regard to any open-end stock acquired before January 1, 2009. An open-end fund, however, may elect (at the time and in the form and manner prescribed by the Secretary), on a stockholder-by-stockholder basis, to treat as covered securities all stock in the fund held by the stockholder without regard to when the stock was acquired. When this election applies, the average cost of a customer's open-end stock is determined by taking into account shares of stock acquired before, on, and after January 1, 2009.

Exception for wash sales

Unless the Secretary provides otherwise, customer's adjusted basis in a covered security generally is determined without taking into account the effect on basis of the wash sale rules of section 1091. If, however, the acquisition and sale transactions resulting in a wash sale under section 1091 occur in the same account and are in identical securities, adjusted basis is determined by taking into account the effect of the wash sale rules. Securities are identical for this purpose only if they have the same Committee on Uniform Security Identification Procedures (CUSIP) number.

Reporting requirements for options

The provision generally eliminates the present-law regulatory exception from section 6045(a) reporting for certain options. If a covered security is acquired by the exercise of an option and the option was acquired in the same account as the covered security, the amount of the premium received or paid for the option is treated as an adjustment to the gross proceeds from the subsequent sale of the covered security or as an adjustment to the customer's adjusted basis in that security. Gross proceeds and basis reporting also generally is required when there is a lapse of, or a closing transaction with respect to, an option on a covered security. These reporting rules related to options transactions apply only to options granted or acquired on or after January 1, 2011.

Time for providing statements to customers

The provision changes to February 15 the present-law January 31 deadline for furnishing certain information statements to customers. The statements to which the new February 15 deadline applies are (1) statements showing gross proceeds (under section 6045(b)) or substitute payments (under section 6045(d)) and (2) consolidated reporting statements (as defined in regulations) for reporting gross proceeds, dividends (under section 6042(c)), interest (under section 6049(c)(2)(A)), or royalties (under section 6050N(b)). The term "consolidated reporting statement" is intended to refer to annual tax information statements that brokerage firms customarily provide to their customers.

Broker-to-broker and issuer reporting

Every broker (as defined in section 6045(c)(1)), and any other person specified in Treasury regulations, that transfers to a broker (as defined in section 6045(c)(1)) a security that is a covered security when held by that broker or other person must, under new section 6045A, furnish to the transferee broker a written statement that allows the transferee broker to satisfy the provision's basis and holding period reporting requirements. The Secretary may provide regulations that prescribe the content of this statement and the manner in which it must be furnished. It is contemplated that the Secretary will permit statements to be provided electronically. The statement required by this rule must be furnished within 45 days after the transfer of the covered security or, if earlier, by January 15 of the year in which the transfer occurred.

Present law penalties for failure to furnish correct payee statements apply to failures to furnish correct statements in connection with the transfer of covered securities.

New section 6045B requires, according to forms or regulations prescribed by the Secretary, any issuer of a specified security to file a return setting forth a description of any organizational action (such as a stock split or a merger or acquisition) that affects the basis of the specified security, the quantitative effect on the basis of that specified security, and any other information required by the Secretary. This return must be filed within 45 days after the date of the organizational action or, if earlier, by January 31 of the year following the calendar year during which the action occurred. Every person required to file this return for a specified security also must furnish, according to forms or regulations prescribed by the Secretary, to the nominee with respect to that security (or to a certificate holder if there is no nominee) a written statement showing the name, address, and phone number of the information contact of the person required to file the return, the information required to be included on the return with respect to the security, and any other information required by the Secretary. This statement must be furnished to the nominee or certificate holder on or before January 31 of the year following the calendar year in which the organizational action took place. No return or information statement is required to be provided under new section 6045B for any action with respect to a specified security if the action occurs before the applicable date (as defined previously) for that security.

The Secretary may waive the return filing and information statement requirements if the person to which the requirements apply makes publicly available, in the form and manner determined by the Secretary, the name, address, phone number, and email address of the information contact of that person, and the information about the organizational action and its effect on basis otherwise required to be included in the return.

The present-law penalties for failure to file correct information returns apply to failures to file correct returns in connection with organizational actions. Similarly, the present-law penalties for failure to furnish correct payee statements apply to a failure under new section 6045B to furnish correct statements to nominees or holders or to provide required publicly-available information in lieu of returns and written statements.

Effective Date

The provision takes effect on January 1, 2009.

3. Increase in penalty for failure to file partnership returns (sec. 623 of the bill and sec. 6698 of the Code)

Present Law

A partnership generally is treated as a pass-through entity. 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).

Under present law, a partnership is required to file a tax return for each taxable year. 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. In addition to applicable criminal penalties, present law imposes a civil penalty for the failure to timely file a partnership return. The penalty is $50 per partner for each month (or fraction of a month) that the failure continues, up to a maximum of five months.

Reasons for Change

A recent report by the Treasury Inspector General for Tax Compliance (TIGTA) indicated that the incidence of late-filed returns, measured as a percentage of total returns filed, is nearly 2 to 4 times higher among partnerships and S corporations, respectively, than it is among individual taxpayers.[235] The TIGTA report indicated that the present-law penalty for partnerships fails to address the most egregious late filers.

The Committee is concerned that the level of filing noncompliance by partnerships adversely affects the compliance of the individual partners. The Committee believes that the present law penalty should be increased to a level that effectively discourages noncompliance. The Committee believes this will improve overall tax administration.

[235] Treasury Inspector General for Tax Administration, Stronger Sanctions Are Needed to Encourage Timely Filing of Pass-Through Returns and Ensure Fairness in the Tax System he Informants' Rewards Program Needs More Centralized Management Oversight, 2005-30-048 (March 2005).

Explanation of Provision

The provision increases the present-law failure to file penalty for partnership returns by $25 per partner times the number of shareholders in the partnership during any part of the taxable year for which the return was required, for each month (or a fraction of a month) during which the failure continues, up to a maximum of 12 months.

Effective Date

The provision applies to returns required to be filed after the date of enactment.

4. Penalty for failure to file S corporation returns (sec. 624 of the bill and new sec. 6699 of the Code)

Present Law

In general, an S corporation is not subject to corporate-level income tax on its items of income and loss. Instead, an 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, S corporations are required to file a tax return for each taxable year. 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.

Reasons for Change

A recent report by the Treasury Inspector General for Tax Compliance ("TIGTA") indicated that the incidence of late-filed returns, measured as a percentage of total returns filed, is nearly 2 to 4 times higher among partnerships and S corporations, respectively, than it is among individual taxpayers.[236] The TIGTA report attributed the high rate of late-filed S corporation returns to the lack of an effective penalty regime.

The Committee believes the level of filing noncompliance by S corporations is unacceptably high. Late-filed S corporation returns can have an adverse effect on the filing and reporting compliance of the individual shareholders. Thus, the Committee believes that establishing an effective penalty for failing to timely file an S corporation return will improve overall tax administration.

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[236] Treasury Inspector General for Tax Administration, Stronger Sanctions Are Needed to Encourage Timely Filing of Pass-Through Returns and Ensure Fairness in the Tax System he Informants' Rewards Program Needs More Centralized Management Oversight, 2005-30-048 (March 2005).

Explanation of Provision

The provision imposes a monthly penalty for any failure to timely file an S corporation return or any failure to provide the information required to be shown on such a return. The penalty is $25 times the number of shareholders in the S corporation during any part of the taxable year for which the return was required, for each month (or a fraction of a month) during which the failure continues, up to a maximum of 12 months.

Effective Date

The provision applies to returns required to be filed after the date of enactment.

5. Modifications to corporate estimated tax payments (sec. 625 of the bill)

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. 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.

Under present law, in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 115 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Reasons for Change

The Committee believes it is appropriate to adjust the corporate estimated tax payments.

Explanation of Provision

The provision increases the percentage from 115 percent to 181 percent.

Effective Date

The provision is effective on the date of enactment.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the votes of the Committee on Ways and Means in its consideration of the bill, H.R. 3996, the "Temporary Tax Relief Act of 2007."

The bill, H.R. 3996, was ordered favorably reported, as amended, by a roll call vote of 22 yeas to 13 nays (with a quorum being present). The vote was as follows:

MOTION TO REPORT RECOMMENDATIONS

The Chairman's Amendment in the Nature of a Substitute, as amended, was ordered favorably reported by a roll call vote of 22 yeas to13 nays (with a quorum being present). The vote was as follows:

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. RANGEL……….	X			Mr. MCCRERY…...		X	
Mr. STARK…………	X			Mr. HERGER……..		X	
Mr. LEVIN………….	X			Mr. CAMP………...			
Mr. MCDERMOTT…	X			Mr. RAMSTAD…...		X	
Mr. LEWIS (GA)…				Mr. JOHNSON….....		X	
Mr. NEAL…………..	X			Mr. ENGLISH…….		X	
Mr. MCNULTY……				Mr. WELLER……..			
Mr. TANNER……….	X			Mr. HULSHOF……		X	
Mr. BECERRA……...	X			Mr. LEWIS (KY)…		X	
Mr. DOGGETT……..	X			Mr. BRADY………		X	
Mr. POMEROY…….	X			Mr. REYNOLDS….		X	
Ms. TUBBS JONES...	X			Mr. RYAN………...		X	
Mr. THOMPSON…...	X			Mr. CANTOR……..		X	
Mr. LARSON……….	X			Mr. LINDER……...			
Mr. EMANUEL……..	X			Mr. NUNES……….			
Mr. BLUMENAUER.	X			Mr. TIBERI……….		X	
Mr. KIND…………...	X			Mr. PORTER……...		X	
Mr. PASCRELL	X						
Ms. BERKLEY	X						
Mr. CROWLEY	X						
Mr. VAN HOLLEN	X						

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. MEEK	X						
Ms. SCHWARTZ	X						
Mr. DAVIS	X						

VOTES ON AMENDMENTS

A roll call vote was conducted on the following amendments to the Chairman's Amendment in the Nature of a Substitute.

An amendment by Mr. McCrery, which would strike all the offsets included in the Chairman's Amendment in the Nature of a Substitute, was defeated by a roll call vote of 13 yeas to 23 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. RANGEL……….		X		Mr. MCCRERY…...	X		
Mr. STARK…………		X		Mr. HERGER……..	X		
Mr. LEVIN………….		X		Mr. CAMP………...			
Mr. MCDERMOTT…		X		Mr. RAMSTAD…...	X		
Mr. LEWIS (GA)…		X		Mr. JOHNSON…...	X		
Mr. NEAL…………..		X		Mr. ENGLISH…….	X		
Mr. MCNULTY……				Mr. WELLER……..			
Mr. TANNER……….		X		Mr. HULSHOF……	X		
Mr. BECERRA……...		X		Mr. LEWIS (KY)…	X		
Mr. DOGGETT……..		X		Mr. BRADY………	X		
Mr. POMEROY…….		X		Mr. REYNOLDS….	X		
Ms. TUBBS JONES...		X		Mr. RYAN………...	X		
Mr. THOMPSON…...		X		Mr. CANTOR……..	X		
Mr. LARSON……….		X		Mr. LINDER……...			
Mr. EMANUEL……..		X		Mr. NUNES……….			
Mr. BLUMENAUER.		X		Mr. TIBERI……….	X		
Mr. KIND…………...		X		Mr. PORTER……...	X		
Mr. PASCRELL		X					
Ms. BERKLEY		X					
Mr. CROWLEY		X					
Mr. VAN HOLLEN		X					

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. MEEK		X					
Ms. SCHWARTZ		X					
Mr. DAVIS		X					

An amendment by Mr. English, which would repeal the individual Alternative Minimum Tax for tax years beginning after January 1, 2018, was defeated by a roll call vote of 13 yeas to 23 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. RANGEL……….		X		Mr. MCCRERY…...	X		
Mr. STARK…………		X		Mr. HERGER……..	X		
Mr. LEVIN………….		X		Mr. CAMP………...			
Mr. MCDERMOTT…		X		Mr. RAMSTAD…...	X		
Mr. LEWIS (GA)…		X		Mr. JOHNSON…....	X		
Mr. NEAL…………..		X		Mr. ENGLISH…….	X		
Mr. MCNULTY……				Mr. WELLER……..			
Mr. TANNER……….		X		Mr. HULSHOF……	X		
Mr. BECERRA……...		X		Mr. LEWIS (KY)…	X		
Mr. DOGGETT……..		X		Mr. BRADY………	X		
Mr. POMEROY…….		X		Mr. REYNOLDS….	X		
Ms. TUBBS JONES...		X		Mr. RYAN………...	X		
Mr. THOMPSON…...		X		Mr. CANTOR……..	X		
Mr. LARSON……….		X		Mr. LINDER……...			
Mr. EMANUEL……..		X		Mr. NUNES……….			
Mr. BLUMENAUER.		X		Mr. TIBERI……….	X		
Mr. KIND…………...		X		Mr. PORTER……...	X		
Mr. PASCRELL		X					
Ms. BERKLEY		X					
Mr. CROWLEY		X					
Mr. VAN HOLLEN		X					
Mr. MEEK		X					
Ms. SCHWARTZ		X					
Mr. DAVIS		X					

An amendment by Mr. Hulshof, which would strike Section 313, which clarifies that the deduction for State Legislators' travel expenses away from home includes Pro Forma session days, was defeated by a roll call vote of 13 yeas to19 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. RANGEL……….		X		Mr. MCCRERY…...	X		
Mr. STARK…………		X		Mr. HERGER……..	X		
Mr. LEVIN………….		X		Mr. CAMP………...			
Mr. MCDERMOTT…		X		Mr. RAMSTAD…...	X		
Mr. LEWIS (GA)…				Mr. JOHNSON….....	X		
Mr. NEAL…………..		X		Mr. ENGLISH…….	X		
Mr. MCNULTY……				Mr. WELLER……..			
Mr. TANNER……….		X		Mr. HULSHOF……	X		
Mr. BECERRA……...				Mr. LEWIS (KY)…	X		
Mr. DOGGETT……..	X			Mr. BRADY………	X		
Mr. POMEROY…….		X		Mr. REYNOLDS….		X	
Ms. TUBBS JONES...		X		Mr. RYAN………...	X		
Mr. THOMPSON…...		X		Mr. CANTOR……..	X		
Mr. LARSON……….		X		Mr. LINDER……...			
Mr. EMANUEL……..		X		Mr. NUNES………			
Mr. BLUMENAUER.	X			Mr. TIBERI……….	X		
Mr. KIND…………...		X		Mr. PORTER……...		X	
Mr. PASCRELL		X					
Ms. BERKLEY		X					
Mr. CROWLEY		X					
Mr. VAN HOLLEN		X					
Mr. MEEK		X					
Ms. SCHWARTZ							
Mr. DAVIS		X					

An amendment by Mr. Brady, which would strike real estate from the list of specified assets in Section 611, was defeated by a roll call vote of 13 yeas to 22 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. RANGEL……….		X		Mr. MCCRERY…...	X		
Mr. STARK…………		X		Mr. HERGER……..	X		
Mr. LEVIN………….		X		Mr. CAMP………...			
Mr. MCDERMOTT…		X		Mr. RAMSTAD…...	X		
Mr. LEWIS (GA)…				Mr. JOHNSON…...	X		
Mr. NEAL…………..		X		Mr. ENGLISH…….	X		
Mr. MCNULTY……				Mr. WELLER……..			
Mr. TANNER……….		X		Mr. HULSHOF……	X		
Mr. BECERRA……...		X		Mr. LEWIS (KY)…	X		
Mr. DOGGETT……..		X		Mr. BRADY………	X		
Mr. POMEROY…….		X		Mr. REYNOLDS….	X		
Ms. TUBBS JONES...		X		Mr. RYAN………...	X		
Mr. THOMPSON…...		X		Mr. CANTOR……..	X		
Mr. LARSON……….		X		Mr. LINDER……...			
Mr. EMANUEL……..		X		Mr. NUNES………			
Mr. BLUMENAUER.		X		Mr. TIBERI……….	X		
Mr. KIND…………...		X		Mr. PORTER……...	X		
Mr. PASCRELL		X					
Ms. BERKLEY		X					
Mr. CROWLEY		X					
Mr. VAN HOLLEN		X					
Mr. MEEK		X					
Ms. SCHWARTZ		X					
Mr. DAVIS		X					

An amendment by Mr. Brady, which would strike Section 404 and include a new provision allowing participants in governmental 457(b) to treat elected deferrals as Roth contributions, was defeated by a roll call vote of 13 yeas to 22 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. RANGEL……….		X		Mr. MCCRERY…...	X		
Mr. STARK…………		X		Mr. HERGER……..	X		
Mr. LEVIN………….		X		Mr. CAMP………...			
Mr. MCDERMOTT…		X		Mr. RAMSTAD…...	X		
Mr. LEWIS (GA)…				Mr. JOHNSON…...	X		
Mr. NEAL…………..		X		Mr. ENGLISH…….	X		
Mr. MCNULTY……				Mr. WELLER……..			
Mr. TANNER……….		X		Mr. HULSHOF……	X		
Mr. BECERRA……...		X		Mr. LEWIS (KY)…	X		
Mr. DOGGETT……..		X		Mr. BRADY………	X		
Mr. POMEROY…….		X		Mr. REYNOLDS….	X		
Ms. TUBBS JONES...		X		Mr. RYAN………...	X		
Mr. THOMPSON…...		X		Mr. CANTOR……..	X		
Mr. LARSON……….		X		Mr. LINDER……...			
Mr. EMANUEL……..		X		Mr. NUNES………			
Mr. BLUMENAUER.		X		Mr. TIBERI……….	X		
Mr. KIND…………...		X		Mr. PORTER……...	X		
Mr. PASCRELL		X					
Ms. BERKLEY		X					
Mr. CROWLEY		X					
Mr. VAN HOLLEN		X					
Mr. MEEK		X					
Ms. SCHWARTZ		X					
Mr. DAVIS		X					

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the revenue provisions of the bill, H.R. 3996, as reported.

The bill is estimated to have the following effects on Federal budget receipts for fiscal years 2008-2017:

[Insert revenue table]

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue-reducing tax provisions involve increased tax expenditures. (See amounts in table in Part IV.A., above.)

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

[Insert CBO letter]

D. Macroeconomic Impact Analysis

In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: the effects of the bill on economic activity are so small as to be incalculable within the context of a model of the aggregate economy.

E. PAY-GO Rule

In compliance with clause 10 of rule XXI of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of title X of the bill, H.R. 3996, as reported: the provisions of the bill affecting revenues have the net effect of not increasing the deficit or reducing the surplus for either: (1) the period comprising the current fiscal year and the five fiscal years beginning with the fiscal year that ends in the following calendar year; and (2) the period comprising the current fiscal year and the ten fiscal years beginning with the fiscal year that ends in the following calendar year.

ESTIMATED REVENUE EFFECTS OF H.R. 3996,
THE "TEMPORARY TAX RELIEF ACT OF 2007,"
AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS

Fiscal Years 2008 - 2017

[Millions of Dollars]

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
I. Individual AMT Relief Provisions													
1. Set AMT exemption amounts at $44,350/$66,250 for 2007 and extend application of nonrefundable credits...............	tyba 12/31/06	-50,593	---	---	---	---	---	---	---	---	---	-50,593	-50,593
2. Increase in AMT refundable credit - remove AGI limits from refundable AMT credit and change usage rate of unused credit from 20% to 50%..	tyba 12/31/06	-1,298	-385	-18	133	128	47	86	99	99	98	-1,440	-1,011
3. Abatement of incentive stock option AMT liability, penalty, and interest..........................	DOE	-174	-174	-151	-151	-136	-114	-99	-91	-84	-76	-786	-1,249
Total of Individual AMT Relief Provisions …………………………		**-52,065**	**-559**	**-169**	**-18**	**-8**	**-67**	**-13**	**8**	**15**	**22**	**-52,819**	**-52,853**
II. Additional Individual Tax Relief													
1. Set refundable threshold for the child tax credit at $8,500 (sunset 12/31/08)...................	tyba 12/31/07	---	-2,869	---	---	---	---	---	---	---	---	-2,869	-2,869
2. Additional standard deduction for real property taxes for nonitemizers equal to the lesser of actual property tax or $350/$700 in 2008..	tyba 12/31/07	-185	-1,049	---	---	---	---	---	---	---	---	-1,234	-1,234
Total of Additional Individual Tax Relief …………………………		**-185**	**-3,918**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**-4,103**	**-4,103**
III. One-Year Extenders													
A. Extenders Primarily Affecting Individuals													
1. Deduction for State and local general sales taxes (sunset 12/31/08)...................................	tyba 12/31/07	-286	-1,685	-363	---	---	---	---	---	---	---	-2,335	-2,335

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
2. Deduction for qualified tuition and related expenses (sunset 12/31/08)............................	tyba 12/31/07	-495	-1,978	---	---	---	---	---	---	---	---	-2,473	-2,473
3. Treatment of certain dividends of regulated investment companies (sunset 12/31/08)........	[1]	-10	-57	---	---	---	---	---	---	---	---	-67	-67
4. Parity in the application of certain limits to mental health benefits (sunset 12/31/08) [2]...	1/1/08	-5	-15	-5	---	---	---	---	---	---	---	-25	-25
5. Encourage contributions of property interests made for conservation purposes (sunset 12/31/08)..	cmi tyba 12/31/07	-27	-25	---	---	---	---	---	---	---	---	-52	-52
6. Tax-free distributions from IRAs to certain public charities from age 70 1/2 or older, not to exceed $100,000 per taxpayer per year (sunset 12/31/08)..	Da 1/1/08	-115	-124	-17	-22	-27	-27	-28	-29	-31	-32	-304	-452
7. Above-the-line deduction of up to $250 for teacher classroom expenses (sunset 12/31/08)..	epoii tyba 12/31/07	-10	-194	---	---	---	---	---	---	---	---	-204	-204
8. Extend election to include combat pay in earned income for purposes of the earned income credit (sunset 12/31/08).....................	tyba 12/31/07	---	-19	---	---	---	---	---	---	---	---	-19	-19
9. Use of qualified mortgage bonds to finance residences for veterans without regard to first-time homebuyer requirement (sunset 12/31/08)..	bia 12/31/07	-3	-12	-18	-18	-18	-18	-18	-18	-18	-18	-69	-159
10. Penalty-free withdrawals from retirement plans for individuals called to active duty (sunset 12/31/08)..	tyba 12/31/07	[3]	[3]	[3]	[3]	---	---	---	---	---	---	-1	-1
11. Estate tax look-through for certain RIC stock held by nonresidents (sunset 12/31/08)...........	dda 12/31/07	- *Negligible Revenue Effect* -											
12. Extend the treatment of RICs as "qualified investment entities" under section 897 (FIRPTA) (sunset 12/31/08)...........................	1/1/08	-5	-5	---	---	---	---	---	---	---	---	-10	-10
13. Treatment of State legislators travel expenses away from home (sunset 12/31/08).................	eio/a 1/1/08	-4	---	---	---	---	---	---	---	---	---	-4	-4
Total of Extenders Primarily Affecting Individuals		-960	-4,114	-403	-40	-45	-45	-46	-47	-49	-50	-5,563	-5,801
B. Extenders Primarily Affecting Businesses													
1. Tax credit for R&E expenses (sunset 12/31/08)..	apoia 12/31/07	-2,881	-2,211	-1,014	-1,014	-1,014	-685	-178	---	---	---	-8,134	-8,998

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
2. Indian employment tax credit (sunset 12/31/08)..	tyba 12/31/07	-21	-28	-9	-1	---	---	---	---	---	---	-59	-59
3. New markets tax credit (sunset 12/31/09).......	ima 12/31/08	---	-106	-168	-170	-192	-205	-202	-202	-77	[4]	-637	-1,322
4. 50% tax credit for certain expenditures for maintaining railroad tracks (sunset 12/31/08).	epoid tyba 12/31/07	-74	-74	-17	---	---	---	---	---	---	---	-165	-165
5. 15-year straight-line cost recovery for qualified leasehold improvements and qualified restaurant property (sunset 12/31/08)..	ppisa 12/31/07	-100	-305	-416	-416	-405	-374	-357	-372	-365	-357	-1,642	-3,466
6. 7-year recovery period for certain motorsports racetrack property (sunset 12/31/08)..	ppisa 12/31/07	-7	-11	-7	-4	-2	-2	-2	1	4	4	-29	-27
7. Accelerated depreciation for business property on Indian reservations (sunset 12/31/08)..	ppisa 12/31/07	-133	-231	-86	19	63	99	81	43	5	-8	-367	-148
8. Expensing of "Brownfields" environmental remediation costs (sunset 12/31/08)................	epoia 12/31/07	-227	-140	21	25	29	26	23	20	17	15	-292	-192
9. Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sunset 12/31/08)....................	tyba 12/31/07	-58	-58	---	---	---	---	---	---	---	---	-116	-116
10. Modify tax treatment of certain payments under existing arrangements to controlling exempt organizations (sunset 12/31/08)..........	proaa 12/31/07	-15	-8	---	---	---	---	---	---	---	---	-23	-23
11. Extension and modification of credit to holders of qualified zone academy bonds - allocations of bond authority (sunset 12/31/08)..	oia 12/31/07	-1	-6	-13	-19	-21	-21	-21	-21	-21	-21	-60	-165
12. Tax Incentives for Investment in the District of Columbia (sunset 12/31/08).......................	tyba 12/31/07	-45	-23	-1	[3]	-2	-6	-15	-19	-23	-23	-71	-158
13. Extension of economic development credit for American Samoa (sunset 12/31/08)...........	tyba 12/31/07	-6	-10	---	---	---	---	---	---	---	---	-16	-16
14. Enhanced charitable deduction for contributions of food inventory (sunset 12/31/08)..	cma 12/31/07	-39	-33	---	---	---	---	---	---	---	---	-72	-72
15. Enhanced charitable deduction for contributions of book inventories to public schools (sunset 12/31/08)...............................	cma 12/31/07	-17	-14	---	---	---	---	---	---	---	---	-31	-31

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
16. Enhanced deduction for qualified computer contributions (sunset 12/31/08)......................	cmd tyba 12/31/07	-120	-98	---	---	---	---	---	---	---	---	-218	-218
17. Basis adjustment to stock of S corporations making charitable contributions of property (sunset 12/31/08)..	tyba 12/31/07	-14	-20	-4	-2	-2	-2	-2	-2	-2	-2	-42	-54
18. Extension of WOTC for Hurricane Katrina employees (sunset 08/28/08)..........................	8/28/07	-6	-8	-4	-2	-1	-1	---	---	---	---	-20	-21
Total of Extenders Primarily Affecting Businesses		-3,764	-3,384	-1,718	-1,584	-1,547	-1,171	-673	-552	-462	-392	-11,994	-15,251
C. Other Extenders													
1. Disclosure of tax return information to facilitate combined employment tax reporting (sunset 12/31/08)............................	da 12/31/07	*No Revenue Effect*											
2. Disclosure of return information to inform officials of terrorist activities (sunset 12/31/08)..	da 12/31/07	*No Revenue Effect*											
3. Disclosure upon request of information relating to terrorist activities (sunset 12/31/08)..	da 12/31/07	*No Revenue Effect*											
4. Disclosure of tax return information to carry out administration of income contingent repayment of student loans (sunset 12/31/08) [2]..	rma 12/31/07	*No Revenue Effect*											
5. Authority for undercover operations (sunset 12/31/08)..	1/1/08	[5]	[5]	---	---	---	---	---	---	---	---	[5]	[5]
6. Increase in Limit on Cover Over of Rum Excise Tax Revenues (from $10.50 to $13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sunset 12/31/08) [2] [6]..........	abiUSa 12/31/07	-74	-19	---	---	---	---	---	---	---	---	-93	-93
7. Extension of disclosure authority to the Department of Veterans Affairs (sunset 12/31/08) [2]..	09/30/08	1	---	---	---	---	---	---	---	---	---	1	1
Total of Other Extenders		-73	-19	---	---	---	---	---	---	---	---	-92	-92
Total of One-Year Extenders		**-4,797**	**-7,517**	**-2,121**	**-1,624**	**-1,592**	**-1,216**	**-719**	**-599**	**-511**	**-442**	**-17,649**	**-21,144**

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
IV. Mortgage Forgiveness Debt Relief Provisions													
1. Exclude discharges of principal residence acquisition indebtedness from gross income [7]..	1/1/07	-173	-241	-216	-149	-79	-83	-88	-99	-103	-107	-858	-1,338
2. Extension of deduction for private mortgage insurance (sunset 12/31/14)............................	apoawrtceia 12/31/06	-15	-109	-142	-134	-137	-97	-83	-52	85	114	-536	-570
3. Alternative tests for qualifying as cooperative housing corporation.......................................	tyea DOE	-1	-2	-2	-2	-2	-3	-3	-3	-3	-3	-9	-21
4. Exclusion of gain on sale of principal residence exclusion not to apply to nonqualified use......	soea 12/31/07	---	43	121	148	171	207	249	297	349	407	483	1,991
Total of Mortgage Forgiveness Debt Relief Provisions		**-189**	**-309**	**-239**	**-137**	**-47**	**24**	**75**	**143**	**328**	**411**	**-920**	**62**
V. Administrative Provisions													
1. Repeal of private debt collection contract authority [8]..	[9]	-35	-101	-106	-116	-116	-116	-116	-116	-116	-116	-474	-1,054
2. Delayed implementation of government withholding..	DOE	---	---	---	-6,079	6,057	-11	-6	-3	-1	---	-23	-44
3. Application of statute of limitations rules to persons claiming U.S. Virgin Islands residency..	tyba 1986	[10]	-1	-3	-5	-10	-10	-5	-3	-1	[10]	-19	-38
4. Revision of tax rules on expatriation of individuals - impose mark-to-market and 10-year income inclusion rule on individuals who expatriate.............................	generally eo/a DOE	40	78	74	75	75	76	77	78	78	79	342	730
5. Repeal suspension of certain interest and penalties where IRS fails to contact taxpayer...	[11]	9	13	13	13	13	13	13	13	13	14	61	128
6. Unused merchandise drawback......................	DOE	- *No Revenue Effect* -											
Total of Administrative Provisions		**15**	**-11**	**-22**	**-6,112**	**6,019**	**-48**	**-37**	**-31**	**-27**	**-23**	**-113**	**-278**
VI. Revenue Provisions													
1. Nonqualified deferred compensation for services performed by foreign firms in non-treaty jurisdictions [12]...........................	spa 12/31/07 [13]	2,086	2,803	2,521	2,447	2,141	1,557	950	466	6,360	2,522	11,998	23,852

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
2. Income of partners for performing investment management services treated as ordinary income received for performance of services [14]..	[15]	2,661	3,211	3,149	2,951	2,687	2,360	2,169	2,028	2,097	2,281	14,658	25,593
3. Indebtedness incurred by a partnership in acquiring securities and commodities not treated as acquisition indebtedness for purposes of the unrelated debt-financed income rules..	tyba DOE	-42	-92	-107	-119	-132	-147	-158	-168	-182	-194	-492	-1,341
4. Application of section 1239 to partnership interests and tax sharing agreements of rule treating certain gain on sales between related persons as ordinary income............................	generally saea DOE	5	10	15	15	15	15	15	15	15	15	60	135
5. Delay implementation of worldwide allocation of interest expense until 2018.........	DOE	---	999	2,736	2,845	2,958	3,077	3,200	3,328	3,461	3,610	9,538	26,214
6. Broker reporting of customer's basis in securities transactions....................................	1/1/09	---	---	34	71	126	328	526	688	759	833	230	3,365
7. Increase in penalty for failure to file partnership returns by $25.............................	rfa DOE	12	25	25	26	27	28	29	30	31	32	115	266
8. $25 penalty for failure to file S corporation returns...	rfa DOE	9	22	23	24	25	26	27	28	28	29	103	241
9. Increase by 66 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2012.........................	DOE	---	---	---	---	39,600	-39,600	---	---	---	---	39,600	---
Total of Revenue Provisions		**4,731**	**6,978**	**8,396**	**8,260**	**47,447**	**-32,356**	**6,758**	**6,415**	**12,569**	**9,128**	**75,810**	**78,325**
NET TOTAL		**-52,491**	**-5,336**	**5,845**	**369**	**51,819**	**-33,663**	**6,064**	**5,936**	**12,374**	**9,096**	**207**	**10**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be December 1, 2007.

[Legend and Footnotes for the Table appear on the following page]

Legend and Footnotes for the Table:

Legend for "Effective" column:

abiUSa = articles brought into the United States after
apoawrtceia = amounts paid or accrued with respect to contracts entered into after
apoia = amounts paid or incurred after
bia = bonds issued after
cma = contributions made after
cmd = contributions made during
cmi = contributions made in
da = disclosures after
Da = distributions after
dda = decedents dying after
DOE = date of enactment
eio/a = expenses incurred on or after
eo/a = expatriations on or after
epoia = expenditures paid or incurred after
epoid = expenses paid or incurred during
epoii = expenses paid or incurred in
frap = Federal regulations are prescribed
ima = investments made after
oia = obligations issued after
pa = payments after
ppisa = property placed in service after
proaa = payments received or accrued after
rfa = returns filed after
rma = requests made after
saea = sales and exchanges after
soea = sales or exchanges after
spa = services performed after
tyba = taxable years beginning after
tyea = taxable years ending after

[1] Effective for dividends with respect to taxable years of regulated investment companies beginning after December 31, 2007.
[2] Estimate provided by the Congressional Budget Office.
[3] Loss of less than $500,000.
[4] Gain of less than $500,000.
[5] Gain of less than $1 million.
[6] Estimate is preliminary and subject to change.
[7] Acquisition indebtedness otherwise eligible for the exclusion is limited to $2 million.
[8] Estimate does not include outlay savings which will be provided by the Congressional Budget Office.
[9] The provision is generally effective on the date of enactment, except for any contract which was entered into before July 18, 2007, and is not renewed or extended after such date. The provision also provides that any private debt collection contract which is entered into on or after July 18, 2007, and any extension or renewal on or after such date of any private debt collection contract shall be void.
[10] Loss of less than $500,000.
[11] Effective for IRS notices issued to taxpayers after November 25, 2007.
[12] Estimate includes interaction with item VI.3.
[13] In the case of compensation attributable to services performed on or before December 31, 2007, effective for last tax year beginning before 2017.
[14] Estimate includes interaction with item VI.1.
[15] The provision is generally effective for taxable years ending after November 1, 2007, for dispositions of partnership interests and partnership distributions after November 1, 2007, and in the case of other income and gain in connection with investment management services by a person holding a disqualified interest in an entity, November 1, 2007. The provision as it relates to publicly traded partnerships is effective for taxable years beginning after December 31, 2009.

CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Peter R. Orszag, Director

November 6, 2007

Honorable Charles B. Rangel
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

The Congressional Budget Office and the Joint Committee on Taxation (JCT) have reviewed the provisions of H.R. 3996, the Temporary Tax Relief Act of 2007, as ordered reported by the Committee on Ways and Means on November 1, 2007. Among its provisions, the legislation would provide relief from the alternative minimum tax (AMT), extend various expiring provisions for one year, make changes to certain tax administration methods (including repealing the authority to contract with private debt collectors), and raise revenue related to the taxation of income from carried interest and deferred compensation. It also would shift some corporate income tax receipts from 2013 into 2012.

CBO and JCT estimate that the bill would increase revenues by $3.1 billion over the 2008-2012 period and by $2.7 billion over the 2008-2017 period. (Those estimates include reductions in off-budget revenues of $8 million over the 2008-2009 period.) CBO and JCT estimate that, under the bill, direct spending would increase by $2.7 billion over the 2008-2012 period and by $2.3 billion over the 2008-2017 period. The estimated budgetary impact of H.R. 3996 is shown in the attached table.

The provision with the largest effect on revenues would raise the exemption amounts for the AMT and extend the use of nonrefundable credits for one year, through 2007, which JCT estimates would reduce revenues by $50.6 billion in 2008. Also, a set of one-year extensions of expiring provisions, such as the research and experimentation tax credit, would reduce revenues by about $21.0 billion over the 2008-2017 period, JCT estimates. In addition, JCT estimates that reducing an income threshold for the refundable child credit would increase direct spending by $2.8 billion in 2009.

Three provisions account for the bulk of increases in revenues estimated for H.R 3996. First, the bill would delay until 2018 the application of rules enacted in 2004 that pertain to the worldwide allocation of interest expenses, which JCT estimates would increase revenues by $26.2 billion over the 2008-2017 period. In addition, the bill would treat certain income of partners from performing investment management services (called "carried interest") as ordinary income for tax purposes, rather than as capital gains, which JCT estimates would increase revenues by $25.6 billion over the 2008-2017 period. Also, H.R. 3996 would require that certain deferred compensation from nontaxable entities be included in current taxable income, which JCT estimates would increase revenues by $23.9 billion over the 10-year period.

CBO and JCT have determined that the bill contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). CBO has determined that the nontax provision of the bill (section 506) contains no private-sector mandates. JCT has determined that the tax provisions of the bill contain four private-sector mandates: (1) limitations on the applicability of the exclusion of gains on the sale of a principal residence; (2) the requirement that income of partners for performing investment management services be treated as ordinary income; (3) the delay in implementation of worldwide allocation of interest expense until 2018; and (4) the requirement that brokers report customers' basis in securities transactions. Based on information provided by JCT, CBO estimates that the aggregate cost of mandates in the bill would exceed the annual threshold established in UMRA for private-sector mandates ($131 million in 2007, adjusted annually for inflation).

Because section 611(d)(4) of the bill relates to the Old-Age, Survivors, and Disability Insurance program (OASDI) under title II of the Social Security Act, it is excluded from review under UMRA. Therefore, CBO has not reviewed it for intergovernmental or private-sector mandates.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact for this estimate is Zachary Epstein, who may be reached at 226-2680.

Sincerely,

Robert A. Sunshine
for Peter R. Orszag
Director

Enclosure

cc: Honorable Jim McCrery
Ranking Republican

November 6, 2007

ESTIMATED CHANGES IN DIRECT SPENDING AND REVENUES UNDER H.R. 3996, THE TEMPORARY TAX RELIEF ACT OF 2007

	By Fiscal Year, in Millions of Dollars											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-2012	2008-2017
CHANGES IN REVENUES												
Title I: Individual AMT Relief	-52,000	-559	-169	-18	-8	-67	-13	8	15	22	-52,754	-52,788
Title III: One-Year Extenders	-4,724	-7,481	-2,121	-1,624	-1,592	-1,216	-719	-599	-511	-442	-17,540	-21,035
Title VI: Revenue Provisions	4,731	6,978	8,396	8,260	47,447	-32,365	6,758	6,415	12,569	9,128	75,810	78,325
Titles II, IV, and V: Other Provisions	-368	-1,440	-290	-6,280	5,941	-55	7	81	270	357	-2,438	-1,776
Total Changes in Revenues	-52,362	-2,502	5,816	338	51,788	-33,694	6,033	5,905	12,343	9,065	3,079	2,727
On-budget	-52,359	-2,497	5,816	338	51,788	-33,694	6,033	5,905	12,343	9,065	3,087	2,735
Off-budget	-3	-5	0	0	0	0	0	0	0	0	-8	-8
CHANGES IN DIRECT SPENDING												
Refundable Tax Credits												
Estimated Budget Authority	65	2,843	0	0	0	0	0	0	0	0	2,908	2,908
Estimated Outlays	65	2,843	0	0	0	0	0	0	0	0	2,908	2,908
IRS Contracting for Debt Collection												
Estimated Budget Authority	-12	-65	-68	-74	-74	-74	-74	-74	-74	-74	-293	-663
Estimated Outlays	-12	-65	-68	-74	-74	-74	-74	-74	-74	-74	-293	-663
Payment of Tax Receipts on Distilled Spirits												
Estimated Budget Authority	74	19	0	0	0	0	0	0	0	0	93	93
Estimated Outlays	74	19	0	0	0	0	0	0	0	0	93	93
Tax Return Information for the Department of Veterans Affairs												
Estimated Budget Authority	0	-1	0	0	0	0	0	0	0	0	-1	-1
Estimated Outlays	0	-1	0	0	0	0	0	0	0	0	-1	-1
Total Changes in Direct Spending												
Estimated Budget Authority	127	2,796	-68	-74	-74	-74	-74	-74	-74	-74	2,707	2,337
Estimated Outlays	127	2,796	-68	-74	-74	-74	-74	-74	-74	-74	2,707	2,337
NET CHANGE IN THE BUDGET DEFICIT OR SURPLUS												
Net Change in the Deficit or Surplus[a]	52,489	5,298	-5,884	-412	-51,862	33,620	-6,107	-5,979	-12,417	-9,139	-372	-390
On-budget	52,486	5,293	-5,884	-412	-51,862	33,620	-6,107	-5,979	-12,417	-9,139	-380	-398
Off-budget	3	5	0	0	0	0	0	0	0	0	8	8

SOURCES: Congressional Budget Office and Joint Committee on Taxation.

NOTES: Components may not add to totals because of rounding.
AMT – Alternative Minimum Tax
IRS – Internal Revenue Service

a. Negative numbers indicate decreases in deficits (or increases in surpluses); positive numbers indicate increases in deficits (or decreases in surpluses).

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it is appropriate and timely to enact the provisions of the bill as reported.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Constitutional Authority Statement

With respect to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 8 ("The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises. . . "), and from the 16th Amendment to the Constitution.

D. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (Pub. L. No. 104-4).

The Committee has determined that the following tax provisions of the reported bill contain Federal private sector mandates within the meaning of Public Law No. 104-4, the Unfunded Mandates Reform Act of 1995: (1) denial of the exclusion of gain on sale of principle residence related to nonqualified use (sec. 404 of the bill); (2) income of partners for performing investment management services treated as ordinary income received for the performance of services (sec. 611 of the bill); (3) delay in application of worldwide allocation of interest expense (sec. 621 of the bill); and (4) broker reporting of customer's basis in securities transactions (sec. 622 of the bill). The costs required to comply with each Federal private sector mandate generally are no greater than the aggregate estimated budget effects of the provision.

The Committee has determined that the revenue provisions of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

E. Applicability of House Rule XXI 5(b)

Clause 5 of rule XXI of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increases within the meaning of the rule.

F. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have "widespread applicability" to individuals or small businesses.

G. Limited Tax Benefits

Pursuant to clause 9 of rule XXI of the Rules of the House of Representatives, the Ways and Means Committee has determined that the bill as reported contains no congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of that rule.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

Due to the complexity of the legislation, compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives was not practical.

H.R. 3996: TEMPORARY TAX RELIEF ACT OF 2007
DISSENTING VIEWS

Although we cannot support this bill, we wish to be clear up-front. We strongly support extension of the AMT patch and the provisions of current law extended in this bill. This Committee should protect the 19 million Americans who are at risk of paying the AMT this year. This Committee should extend business tax incentives important to this nation's economy.

Unfortunately, at its core, this bill is not about the extenders. This bill is about the sad triumph of form over substance, as Paygo's full reach, warts and all, has been fully revealed for all to see.

DISTORTS THE AIMS OF PAYGO

While there are valid reasons to apply the principles of Paygo to spending changes, we think the calculus is far different in the case of tax policy.

As was amply documented during the mark-up, by assuming that federal revenues must continue to equal what the Congressional Budget Office shows to be the current law baseline, the Paygo system effectively locks-in tax increases. The Majority's budget assumes that the federal government will generate revenue from allowing the AMT to continue to plague taxpayers and from allowing the 2001 and 2003 tax cuts to sunset. These budget assumptions will have the effect of raising taxes on Americans by $3.5 trillion over the next decade. Paygo posits that the only question for Congress is whether we will let those tax increases take place or replace them with other tax hikes.

It is true that under the current iteration of Paygo, tax cuts could be "paid for" by spending cuts, but we have seen no appetite of the current Majority for such a sensible approach. From small bills – like one providing a vote in Congress for the District of Columbia – to large ones – like the Farm bill – the Ways and Means Committee has become an ATM for other Committees, spitting out tax increases of whatever shape or size is deemed necessary to meet the new Majority's appetite for additional spending.

That was bad enough, but at least those changes can be said to be consistent with the underlying rationale of Paygo – that new spending is being "offset."

What Paygo has become, as embodied in this bill, would be comical were it not so tragic. Here, it is being invoked as a reason for Congress to raise taxes in order to prevent a tax increase.

If Congress does not enact this legislation, Americans will pay about $70 billion more in taxes over the next decade than if we just extend current law – with respect to both the AMT and other expiring tax provisions -- for another year. So to prevent that set of

Americans from facing these higher taxes, this bill proposes to find some other set of Americans to shoulder the burden.

And let us keep in mind that this bill imposes permanent tax increases to pay for temporary tax cuts. We expect to be back here again next year – one would hope before November 1 – struggling again to find another $70-plus billion dollars to "rent" one more year of preventing tax increases while permanently increasing another set of taxes.

Unfortunately, this is just a baby step. Under the next President, we could face tax increases in order to "prevent" a tax increase on families with children, tax increases on marriage, marginal tax rate increases, or tax increases on death. And that's before we are asked to enact other tax increases to pay for new tax incentives or new spending programs.

Raising taxes to prevent a tax increase is circular reasoning at its worst and shows the danger of turning a campaign slogan into a procedural strait-jacket.

The irony of all this is that the very basis of Paygo, the assumption that the stream of revenue bureaucrats predict will come in to the federal government should be maintained, is divorced from reality.

According to estimates by the Congressional Budget Office and the Joint Tax Committee, federal revenues in fiscal year 2007 totaled about 18.6% of our economy, well above the historical average of 18.2%.

In dollar figures, the Joint Tax Committee estimates that over the next decade, revenues will exceed 18.2% of GDP every single year and will reach 20.1% in 2017, a level seen only once since at least 1962.

We could have adopted the Ranking Members' amendment to strike the offsets in the extenders section of the bill and still been assured that the bill would represent little more than a speed bump to federal revenues on their rapid climb to what Mr. Ryan pointed out would be never-before-seen levels by the middle of this century.

But, having elevated legislative process over substance, the Majority rejected that approach.

It is likely the House will soon pass this bill, but what happens next is anyone's guess. As the Chairman knows, the Senate has given us strong signals that they intend to reject offsets to pay for an extenders bill. Nine of the ten Republicans on the Finance Committee sent a letter to Chairman Baucus expressing their support for passing a bill patching the AMT and extending other provisions that expire this year without offsets. The Chairman of the Finance Committee has given signals that he does not believe he can get the votes needed to pass a fully offset extenders package.

But even if the Senate were going to pass the bill we are marking up today, the Administration has indicated the President doesn't support it. That suggests we will spend more days debating this issue, even as the continued delay in passing an AMT patch will increase the havoc of the 2007 tax filing season.

Two days before the mark-up, the Chairman and the Ranking Member, joined by their counterparts on the Senate Finance Committee, signed a letter to the Acting Commissioner of the IRS pledging to pass an AMT patch "in a form mutually agreeable to the Congress and the President before the end of the year."

We would be thrilled if such a simple solution actually addressed the problem, but the letter back the following day from the Acting Commissioner of the IRS, Linda Stiff, made clear it would not. In her letter, she indicated that "key systems can only accommodate one programming option without introducing excessive risk.... Therefore, until the legislation is passed and signed into law, our systems cannot be fully programmed for the proposed AMT patch.... Even with the planning and design that your letter facilitates, we still estimate a timeframe of approximately 10 weeks after enactment before we can process affected tax returns...."

Given the opposition of the Administration to this proposal; the clear indication from the IRS that they cannot address this without legislation; and the strong signals the Senate is sending about its unwillingness to take up this, we wish the Majority would heed the advice of the letter the Chairman signed last Tuesday and work toward passing a product that we know has a chance to get to the White House and be signed by the President as soon as possible.

We have few legislative days left this year and are playing an expensive game of chicken with the American taxpayers who are facing the prospect of a massive tax increase from our inaction on the AMT.

As the Secretary of the Treasury warned us last week, "enactment of a patch in mid-to-late December could delay issuance of approximately $75 billion in refunds to taxpayers who are likely to file their returns before March 31, 2008." That would be on top of the confusion it will cause taxpayers and the added costs the federal government will pay to print new forms and provide assistance to perplexed taxpayers.

Simply put, we should stop this charade and recognize that we need to promptly pass a patch and extenders package that the Senate can pass and that the President can sign. Sadly, such a measure was rejected, and the cost of delay and inaction on the AMT patch will continue to mount.

FAILED TO ACCOMMODATE OTHER REASONABLE AMENDMENTS

We are also disappointed that the majority chose to reject a number of reasonable amendments that we believe would have significantly improved the bill.

An amendment offered by Mr. Hulshof would have struck the expansion of the provision which allows state legislators a per diem deduction that, we were informed, might allow some state legislators to claim tens of thousands of dollars in deductions for long stretches of time, including weekends, that their Chamber is largely dormant, meeting only in pro forma session a couple of times a week.

This provision blocks the way for the Treasury Department to complete its regulatory guidance on this issue, and we were disappointed by rejection of the amendment.

Another amendment offered by Mr. English would have repealed the AMT in 2018. Despite all the Congressional blather about the inequity of the AMT, this too was voted down. We are aware that the Chairman intends to repeal the AMT before 2018 and we would support efforts to do so that aren't predicated on massive tax hikes. Yet that endeavor faces a number of significant challenges and it is far from certain that it will ultimately succeed. The aims of the Chairman and the English amendment are not mutually exclusive; rather they are complementary.

Some suggested this amendment was simply an accounting gimmick, exploiting the scoring rules Congress has imposed upon itself. To this, we suggest that one need look no further than Paygo itself to see the greatest manipulation of self-imposed accounting rules to achieve a predetermined outcome. Indeed, this Amendment is far more sensible than the tortured logic of raising taxes to prevent a tax increase.

Finally, Mr. Brady offered an amendment that would have allowed real estate transactions to continue to receive capital gains treatment on "carried interest" arrangements. Much has been said and written about the unfairness of hedge funds and private equity firms receiving capital gains treatment on their carried interest arrangements. We disagree with that assertion but the Brady Amendment was not an attempt to litigate that issue.

Instead, it was an attempt to prevent this far-reaching change in partnership law from having such a broad reach that it interfered with transactions that are much more Main Street than Wall Street. Over the years we have learned that as goes real estate, so goes the rest of the economy. We should not compound the current struggles of the real estate sector with a tax hike that strikes many as more about class warfare than tax reform.

Mr. Brady also sought to prevent another tax increases that could further weaken the real estate sector. To offset the cost of a provision giving relief for homeowners facing a tax burden from having all or part of the mortgage on their primary home forgiven, the bill reduces the amount of capital gains a homeowner could exclude from the sale of a second home. We are concerned this may discourage such investments. Mr. Brady's amendment offered a better way to pay for the mortgage relief without weakening the real estate investment market and would have improved the bill. We were disappointed by its defeat.

RELITIGATES PRIVATE COLLECTION AGENCY ISSUE

This bill also relitigates the private collection agency (PCAs) issue. By using PCAs, the IRS is collecting tax liabilities that would otherwise go uncollected. This would be true even if the IRS had a greater enforcement budget. This program actually contributes to closing the tax gap. But the Democrats wish to end this program and ignore the revenue it produces by allowing tax liabilities to go unpaid.

These are tax liabilities which are not in dispute. The taxpayer simply chose not to pay, even after the IRS sent multiple notices reminding the affected taxpayers of their unpaid obligation. The Majority is willing to raise taxes to pay for killing this tax gap closing program. We think there is a better way to cut taxes for hard working Americans than to let tax deadbeats off the hook for their legitimate and legal tax obligations.

CONCLUSION:

As we have noted, this bill seems doomed to hit a brick wall, likely in the Senate, sending it back here for a new start. We wish the Majority would recognize that reality and begin the process now rather than waiting for the inevitable, which will only put the IRS further behind schedule in administering the 2007 tax filing season.

The confusion and anger that inaction will cause will be easy to measure but difficult to solve.

Jim McCrery
Wally Herger
Dave Camp
Jim Ramstad
Sam Johnson
Phil English
Jerry Weller
Kenny Hulshof
Ron Lewis
Kevin Brady
Paul Ryan
Eric Cantor
John Linder
Devin Nunes
Pat Tiberi
Jon Porter

H.R. 3996, the “Temporary Tax Relief Act of 2007”
Dissenting Views