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ADOPTION PROMOTION AND STABILITY ACT OF 1996

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Mr. ROTH, from the Committee on Finance,
submitted the following

REPORT

[To accompany H.R. 3286]

The Committee on Finance, to which was referred the bill (H.R. 3286) to help families defray adoption costs, and to promote the adoption of minority children, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

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I. LEGISLATIVE BACKGROUND AND SUMMARY

A. LEGISLATIVE BACKGROUND

The Senate Committee on Finance marked up H.R. 3286 ("Adoption Promotion and Stability Act of 1996") on June 12, 1996. The Committee on Finance amended Titles, I, II, and IV of the bill.

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H.R. 3286 was passed by the House of Representatives on May 10, 1996. As passed by the House, title I of the bill would provide a tax credit for certain adoption expenses and an exclusion for certain employer-provided adoption expenses; title II of the bill would remove certain barriers to interethnic adoptions; Title III of the bill would modify child custody proceedings affected by the Indian Child Welfare Act of 1978; and Title IV of the bill would provide two revenue offsets: (1) remove business exclusion for energy subsidies provided by public utilities, and (2) modify treatment of foreign trusts.

The Committee on Finance ordered the bill, as amended, favorably reported by voice vote on June 12, 1996. The bill is to be referred to the Senate Committee on Indian Affairs for a period of 10 legislative days for consideration of Title III of the bill.

B. Summary

H.R. 3286, as amended by the Committee on Finance, provides: (1) a tax credit for certain adoption expenses and an exclusion for amounts received by an employee for certain adoption expenses under an employer adoption assistance program (Title I); (2) removal of barriers to interethnic adoptions (Title II); and (3) revenue offsets for the bill (repeal of bad debt deduction for certain thrift institutions and modification of the depreciation rules under the income forecast method of accounting). The Committee on finance only acted on titles I, II, and IV of the bill. Title III (relating to child custody proceedings affected by the Indian Child Welfare Act of 1978) will be referred to the Committee on Indian Affairs for a period of 10 legislative days.

II. EXPLANATION OF THE BILL

A. Tax Credit and Exclusion for Adoption Expenses (Sec. 101 of the Bill and New Secs. 23 and 137 of the Code)

Present law

Under present law, the Federal Adoption Assistance program (a Federal outlay program) provides financial assistance for the adoption of certain special needs children. In general, a special needs child is defined as a child who (1) according to a State determination, could not or should not be returned to the home of the natural parents and (2) on account of a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical conditions, or physical, mental or emotional handicap), could not reasonably be expected to be adopted unless adoption assistance is provided. Specifically, the program provides assistance for adoption expenses for those special needs children receiving Federally assisted adoption assistance payments as well as special needs children in private and State-funded programs. The maximum Federal reimbursement is $1,000 per special needs child. Reimbursable expenses include those nonrecurring costs directly associated with the adoption process such as legal costs, social service review, and transportation costs.

Present law provides no specific Federal tax benefits to encourage adoption.

Reason for change

The Committee believes that the financial costs of the adoption process should not be barrier to adoption. In addition, the Committee wishes to encourage further the adoption of special needs children, as defined under present law section 473(c) of the Social Security Act. Therefore in the case of special needs adoptions, the maximum tax credit is increased from $5,000 to $6,000, and it is not subject to the sunset. Similarly, the allowable exclusion under an employer adoption assistance program is increased from $5,000 to $6,000 in the case of a special needs adoption

The Committee believes that encouraging adoptions in an efficient manner requires a continuous effort to improve the delivery of Federal subsidies. For this reason, the Committee believes that a Treasury Department study is necessary to determine whether the adoption credit and exclusion are an efficient Federal subsidy.

Explanation of provision

Tax credit

The bill provides taxpayers with a maximum nonrefundable credit against income tax liability of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. In the case of a special needs adoption, the maximum credit amount is $6,000. Any unused adoption credit may be carried forward by the taxpayer for up to five years. Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys' fees, and other expenses that are directly related to the legal adoption of an eligible child. All reasonable and necessary expenses required by a State as a condition of adoption and qualified adoption expenses. For example, expenses may include the cost of construction, renovations, alterations of purchases specifically required by the State to meet the needs of the child. In the case of an adoption of a child who is not a citizen or a resident of the United States (foreign adoption), the credit is not available unless the adoption is finalized. In the case of otherwise qualified expenses that are incurred in an adoption that is not yet identified as either a domestic or a foreign adoption, the credit would not be available until the expenses are identified as either relating to a domestic adoption (whether or not finalized) or to a finalized foreign adoption. In some instances that may require the filing of an amended tax return. An eligible child is an individual (1) who has not attained age 18 or (2) who is physically or mentally incapable of caring for himself or herself. After December 31, 2000, the credit will be available only for special needs adoptions. No credit is allowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, (3) in connection with the adoption assistance program or otherwise. The credit is phased out ratably for taxpayers with modified adjusted gross income (AGI) above $75,000, and is fully phased out at $115,000 of modified AGI.

The $5,000 limit is a per child limit, not an annual limitation. For example, if in the case of an attempt to adopt a child a taxpayer incurs $3,000 of qualified adoption expenses in year one and $3,000 of qualified adoption expenses in year two, then the taxpayer would receive a $3,000 credit in year one and a $2,000 credit

in year two. To illustrate further, if a taxpayer incurs $1,000 of otherwise qualified adoption expenses at each of three agencies in unsuccessful attempts to adopt a child before incurring $4,000 of otherwise qualified adoption expenses in a successful domestic adoption, the taxpayer's maximum adoption credit is $5,000, not $7,000.

To avoid a double benefit, the bill denies the credit to taxpayers to the extent the taxpayer may use otherwise qualified adoption expenses as the basis of another credit or deduction. Similarly, the credit is not allowed for any expenses for which a grant is received under any Federal, State, or local program. This denial of the credit also applies in the case of special needs adoptions.

The bill provides that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from each other for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Further, the bill provides that an individual legally separated from his or her spouse under a decree of divorce or separate maintenance is not considered married for purposes of this provision.

Exclusion from income

The bill provides a maximum $5,000 exclusion from the gross income of an employee for qualified adoption expenses (as defined above) paid by the employer. The $5,000 limit is a per child limit, not an annual limitation. In the case of a special needs adoption, the maximum exclusion from income is $6,000. No exclusion is allowed for expenses paid by an employer after December 31, 2000. In order for the exclusion to apply, the expenses would have to be paid under an adoption assistance program in connection with an adoption of an eligible child (as described above) by an employee.

An adoption assistance program is a nondiscriminatory plan of an employer under which the employer provides employees with adoption assistance. Also, not more than 5 percent of the benefits under the program for any year may benefit a class of individuals consisting of more than 5-percent owners of the employer and the spouses or dependents of such more than 5-percent owners. An adoption assistance program is not required to be funded but must provide reasonable notification of the availability and terms of the program to eligible employees. An adoption reimbursement program operated under section 1052 of title 10 of the U.S. Code (relating to the armed forces) or section 514 of title 14 of the U.S. Code (relating to members of the Coast Guard) is treated as an adoption assistance program for these purposes. Adoption assistance is a qualified benefit under a cafeteria plan. The exclusion is phased out ratably for taxpayers with modified AGI above $75,000 and is fully phased out at $115,000 of modified AGI. Employees are not entitled to claim the adoption tax credit with respect to excludable adoption expenses paid or reimbursed under an employer's adoption assistance program.

Under the bill, the Secretary has the authority to issue regulations to carry out these provisions, including regulations treating

unmarried individuals as one taxpayer with respect to the same child.

Treasury study

The Secretary of the Treasury is directed to prepare a study of the effects of the tax credit and exclusion on both non-special needs adoptions and special needs adoptions, to be submitted to the House Committee on Ways and Means and the Senate Committee on Finance by January 1, 2000.

Effective date

The provision is effective for taxable years beginning after December 31, 1996.

B. REMOVAL OF BARRIERS TO INTERETHNIC ADOPTIONS (SEC. 201 OF THE BILL AND SECS. 471(a) AND 474 OF THE SOCIAL SECURITY ACT)

Present law

State law governs adoption and foster care placement. Many States permit race matching of foster and adoptive parents with children either by regulation, statute, policy, or practice. The Howard M. Metzenbaum Multiethnic Placement Act of 1994, Public Law 103–382 ("Metzenbaum Act"), permits States to consider race and ethnicity in selecting a foster care or adoptive home, but States cannot delay or deny the placement of the child solely on the basis of race, color, or national origin.

Noncompliance with the Metzenbaum Act is deemed a violation of Title VI of the Civil Rights Act of 1964.

Reasons for change

The Committee is concerned that Public Law 103–382 was not having the intended effect of facilitating the adoption of minority children. In addition, Public Law 103–382 lacked an enforcement provision backed by serious penalties. As a result, the law was ineffective in promoting the best interests of children by decreasing the length of time they wait to be adopted.

Under the terms of the Committee bill, "race, color or national origin" cannot be used to delay or deny the placement of a child into a foster or adoptive placement. The Committee agreed that any delay is clearly not in the child's best interest and must not be tolerated for the purposes of race-matching. The major concern of the Committee is to ensure that States that can be shown to pursue policies that lead to any delay in the adoption of any child be subjected to the penalty terms of this legislation.

Explanation of provision

Under the bill, "race, color or national origin" cannot be used to delay or deny the placement of a child into a foster or adoptive placement. Under the bill, section 558 of the Metzenbaum Act is repealed. In addition, the bill amends the State plan requirements of section 471 of the Social Security Act to prohibit a State or other entity that receives Federal assistance from denying to any person the opportunity to become an adoptive or a foster parent on the basis of the race, color, or national origin of the person or of the

child involved. Similarly, no State or other entity receiving Federal funds can delay or deny the placement of a child for adoption or foster care in making a placement decision, on the basis of the race, color, or national origin of the adoptive or foster parent or the child involved.

Section 474 of the Social Security Act is amended to require the Secretary of Health and Human Services ("HHS") to reduce the amount of Federal foster care and adoption funds provided to the State through Title IV–E if the State program is found in violation of this provision as a result of a review conducted under section 1123 of the Social Security Act. States found to be in violation will have their quarterly funds reduced by 2 percent for the first violation, by 5 percent for the second violation, and by 10 percent for the third or subsequent violation.

The bill clarifies that the Secretary of HHS shall apply penalties in conformance with section 1123 procedures. The bill clarifies that penalties will be assessed on a fiscal year basis. The bill limits to 25 percent the maximum amount the Secretary of HHS can reduce a State's grant in a quarter.

Private entities found to be in violation of this provision for a quarter will be required to return to the Secretary of HHS all federal funds received from the State during the quarter.

Any individual who is harmed by a violation of this title of the bill could seek redress in any United States District Court. An action under this title could not be brought more than two years after the alleged violation occurred.

Noncompliance with Title II of the bill will constitute a violation of Title VI of the Civil Rights Act of 1964. The Indian Child Welfare Act of 1978 will not be affected by changes made by the bill.

Effective date

The provisions related to civil rights enforcement are effective upon enactment. The provisions related to State plan requirements are effective on January 1, 1997.

C. Revenue Offsets

1. TREATMENT OF BAD DEBT DEDUCTIONS OF THRIFT INSTITUTIONS (SEC. 401 OF THE BILL AND SEC. 593 OF THE CODE)

Present law and background

Reserve method of accounting for bad debts of thrift institutions

Generally, a taxpayer engaged in a trade or business may deduct the amount of any debt that becomes wholly or partially worthless during the year (the "specific charge-off" method of sec. 166). Certain thrift institutions (building and loan associations, mutual savings banks, or cooperative banks) are allowed deductions for bad debts under rules more favorable than those granted to other taxpayers (and more favorable than the rules applicable to other financial institutions). Qualified thrift institutions may compute deductions for bad debts using either the specific charge-off method or the reserve method of section 593. To qualify for this reserve method, a thrift institution must meet an asset test, requiring that

60 percent of its assets consist of "qualifying assets" (generally cash, government obligations, and loans secured by residential real property). This percentage must be computed at the close of the taxable year, or at the option of the taxpayer, as the annual average of monthly, quarterly, or semiannual computations of similar percentages.

If a thrift institution uses the reserve method of accounting, it must establish and maintain a reserve for bad debts and charge actual losses against the reserve, and is allowed a deduction for annual additions to restore the reserve to its permitted balance. Under section 593, a thrift institution annually may elect to calculate its addition to its bad debt reserve under either (1) the "percentage of taxable income" method applicable only to thrift institutions, or (2) the "experience" method that also is available to small banks.

Under the "percentage of taxable income" method, a thrift institution generally is allowed a deduction for an addition to its bad debt reserve equal to 8 percent of its taxable income (determined without regard to this deduction and with additional adjustments). Under the experience method, a thrift institution generally is allowed a deduction for an addition to its bad debt reserve equal to the greater of: (1) an amount based on its actual average experience for losses in the current and five preceding taxable years, or (2) an amount necessary to restore the reserve to its balance as of the close of the base year. For taxable years beginning before 1988, the "base year" was the last taxable year before the most recent adoption of the experience method (i.e., generally, the last year the taxpayer was on the percentage of taxable income method). For taxable years beginning after 1987, the base year is the last taxable year beginning before 1988. Prior to 1988, computing bad debts under a "base year" rule allowed a thrift institution to claim a deduction for bad debts for an amount at least equal to the institution's actual losses that were charged off during the taxable year.

Bad debt methods of commercial banks

A small commercial bank (i.e., one with adjusted bases of assets of $500 million or less) may use the experience method or the specific charge-off method for purposes of computing its deduction for bad debts. A large commercial bank only may use the specific charge-off method of section 166. If a small bank becomes a large bank, it must recapture its existing bad debt reserve (i.e., include the amount of the reserve in income) through one of two elective methods. Under the 4-year recapture method, the bank generally includes 10 percent of the reserve in income in the first taxable year, 20 percent in the second year, 30 percent in the third year, and 40 percent in the fourth year. Under the cut-off method, the bank generally neither restores it bad debt reserve to income nor may it deduct losses relating to loans held by the bank as of the date of the required change in the method of accounting. Rather, the amount of such losses are charged against and reduce the existing bad debt reserve, any losses in excess of the reserve are deductible. Any reserve balance in excess of the balance of related loans is included in income.

Recapture of bad debt reserves by thrift institutions

If a thrift institution becomes a commercial bank, or if the institution fails to satisfy the 60-percent qualified asset test, it is required to change its method of account for bad debts and, under proposed Treasury regulations,[1] is required to recapture its bad debt reserve. The percentage-of-taxable-income portion of the reserve generally is included in income ratably over a 6-taxable year period. The experience method portion of the reserve is not restored to income if the former thrift institution qualifies as a small bank. If the former thrift institution is treated as a large bank, the experience method portion of the reserve is restored to income ratably over a 6-taxable year period, or under the 4-year recapture method or the cut-off method described above.

In addition, a thrift institution may be subject to a form of reserve recapture even if the institution continues to qualify for the percentage of taxable income method. Specifically, if a thrift institution distributes to its shareholders an amount in excess of its post-1951 earnings and profits, such excess is deemed to be distributed from the non-experience portion of the institution's bad debt reserve and is restored to income. In the case of any distribution in redemption of stock or in partial or complete liquidation of an institution, the distribution is treated as first coming from the non-experience portion of the bad debt reserves of the institution (sec. 593(e)).

Financial accounting treatment of tax reserves of bad debts of thrift institutions

The recapture of a bad debt reserve for Federal income tax purposes may have significant financial and regulatory accounting implications for a thrift institution. In general, for financial accounting purposes, a corporation must record a deferred tax liability with respect to items that are deducted for tax purposes in a period earlier than they are expensed for book purposes. The deferred tax liability signifies that, although a corporation may be reducing its current tax expense because of the accelerated tax deduction, the corporation will become liable for tax in a future period when the timing item "reverses" (i.e., when the item is expensed for book purposes but for which the tax deduction had already been allowed). Under the applicable accounting standard (Accounting Principles Board Opinion 23), deferred tax liabilities generally were not required for pre-1988 tax deductions attributable to the bad debt reserve method of thrift institutions because the potential reversal of the bad debt reserve was indefinite (i.e., generally, a reversal only would occur by operation of sec. 593(e), a condition within the control of a thrift institution). However, the establishment of 1987 as a base year increased the likelihood of bad debt reserve reversals with respect to post-1987 additions to the reserve and it appears that thrift institutions generally have recorded additional deferred tax liabilities for these additions under the current generally accepted accounting principles.[2]

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[1] Prop. Treas. reg. sec. 1.593–13.

[2] For taxable years beginning before 1988, the base year balance of a thrift institution was the reserve balance whenever the institution changed from one bad debt method to another (e.g., from the percentage of taxable income method to the experience method). How the establish-

Under proposed Treasury regulations, if a thrift institution becomes a commercial bank (or is otherwise ineligible to use the bad debt reserve method of sec. 593), the institution would be required to recapture all or a portion of its bad debt reserve. As described in detail below, it appears that such recapture would require the institution immediately to record, for financial accounting purposes, a current or deferred tax liability for the amount of bad debt recapture for which liabilities previously had not been recorded (generally, with respect to the pre-1988 reserves), regardless of when such recapture is taken into account for Federal income tax purposes. To the extent regulatory accounting principles follow these financial accounting principles, the recording of this liability generally would decrease the regulatory capital of the institution.

Reasons for change

The Committee believes that the reserve method of bad debts accorded to qualified thrift institutions under present law results in a mismeasurement of economic income and provides those institutions with a tax benefit not provided to similarly-situated depository institutions.

The Committee also believes that whenever a taxpayer changes its method of accounting, it is appropriate to implement the change in a manner so that items of income or expense are not taken into account twice—once under the old method and again under the new method. Thus, under present law, most accounting method changes are implemented under section 481 which requires the calculation of an adjustment that reflects the cumulative effect of the method change and is restored to income over a specified period of time. Specifically, under present law, whenever a thrift institution no longer qualifies for the reserve method of accounting for bad debts, the bad debt reserve of the thrift institution must be restored to income.

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ment of 1987 as a permanent base year changed the nature of the bad debt reserves of thrift institutions between pre-1988 years and post-1987 years (which, in turn, contributed to the change in the financial accounting treatment of such reserves) can be illustrated by the following example:

Assume that a thrift institution ("T") always had used the percentage of taxable income ("PTI") method to deduct bad debts through 1986 when its reserve balance was $10,000. Further assume that in 1987, T: (1) has insufficient taxable income to use the PTI method, (2) has actual bad debt losses of $1,000, and (3) under the six-year average formula of the experience method, would be allowed a deduction of $900. Under these facts, T would be allowed a bad debt deduction of $1,000 (rather than $900) in 1987 because $1,000 is the amount necessary to restore the reserve to its base year (PTI) level. Specifically, in 1987, T would charge the year-end 1986 reserve of $10,000 for the $1,000 actual loss and then add (and deduct) $1,000 to the reserve so that the balance of the reserve at year end 1987 is once again $10,000. Thus, T's former PTI deductions, which gave rise to the $10,000 reserve balance, generally would not be restored to income (unless subject to sec. 593(e)).

Further assume that in 1988, T has sufficient taxable income to be allowed a PTI deduction of $1,500, increasing the balance of the reserve to $11,500 at year-end 1988. Further assume that in 1989, T: (1) again has insufficient taxable income to use the PTI method, (2) has actual bad debts of $2,500, and (3) under the six-year average formula of the experience method would be allowed a deduction of $900. Under these facts, T would be allowed a deduction of $1,000 (i.e., the amount necessary to restore the reserve to its base year (year-end 1987) level). Specifically, T would charge the year-end 1988 reserve balance of $11,500 for the $2,500 actual loss and then add (and deduct) $1,000 to the reserve to restore the balance to the $10,000 base year amount. Thus, T's post-1987 PTI deduction of $1,500 is restored to income (i.e., T actually had losses of $2,500 in 1989, but only was allowed to deduct $1,000).

The Committee also understands that a thrift institution may record a current or deferred tax liability in cases where the institution's deduction for bad debts may be limited under section 585(b)(2)(B)(ii) because the amount of institution's loans outstanding diminished from the close of the base year to the close of the current year.

The Committee believes that, in order to provide treatment to similarly-situated depository institutions, the special bad debt reserve methods available to qualified thrift institutions should be repealed. However, the Committee understands that requiring full recapture of the bad debt reserves of thrift institutions in implementing this change in accounting method may impose significant financial accounting and regulatory capital burdens on institutions that have not recorded the appropriate amount of deferred tax liabilities with respect to such recapture. Thus, the Committee believes it is appropriate to provide relief from the recapture of the portion of the bad debt reserves that arose prior to 1988. The Committee believes that this relief should not directly benefit the shareholders of the institutions in a manner similar to the way in which present-law section 593(e) provides a limitation on the direct enjoyment of the benefits of section 593 by shareholders of thrift institutions.

Further, because of the thrift industry's traditional role as home mortgage lenders, the Committee is concerned that the repeal of section 593 may result in a temporary shortage in the availability of mortgage loans in some regions. The Committee bill addresses this issue by providing an incentive for institutions to continue to provide a level of residential mortgage financing for a period of time.

Explanation of provision

Repeal of section 593

The bill repeals the section 593 reserve method of accounting for bad debts by thrift institutions, effective for taxable years beginning after 1995. Thrift institutions that would be treated as small banks[3] are allowed to utilize the experience method applicable to such institutions, while thrift institutions that are treated as large banks are required to use only the specific charge-off method. Thus, the percentage of taxable income method of accounting for bad debts is no longer available for any financial institution. The bill also repeals the following present-law provisions that only apply to thrift institutions to which section 593 applies: (1) the denial of a portion of certain tax credits to a thrift institution (sec. 50(d)(1)); (2) the special rules with respect to the foreclosure of property securing loans of a thrift institution (sec. 595); (3) the reduction in the dividends received reduction of a thrift institution (sec. 596); and (4) the ability of a thrift institution to use a net operating loss to offset its income from a residual interest in a REMIC (sec. 860E(a)(2)).

Treatment of recapture of bad debt reserves

In general.—A thrift institution required to change its method of computing reserves for bad debts will treat such change as a change in a method of accounting, initiated by the taxpayer, and having been made with the consent of the Secretary of the Treas-

[3] Under present-law section 581, the definition of a "bank" includes a thrift institution.

ury.[4] Any section 481(a) adjustment required to be taken into account with respect to such change generally with be determined solely with respect to the "applicable excess reserves" of the taxpayer. The amount of applicable excess reserves shall be taken into account ratably over a six-taxable year period, beginning with the first taxable year beginning after 1995, subject to the residential loan requirement described below. In the case of a thrift institution that becomes a "large bank" (as determined under sec. 585(c)(2)), the amount of the institution's applicable excess reserves generally is the excess of (1) the balance of its reserves described in section 593(c)(1) other than its supplemental reserve for losses on loans (i.e., its reserve for losses on qualifying real property loans and its reserve for losses on nonqualifying loans) as of the close of its last taxable year beginning before January 1, 1996, over (2) the balance of such reserves (i.e., its reserve for losses on qualifying real property loans and its reserve for losses on nonqualifying loans) as of the close of its last taxable year beginning before January 1, 1988 (i.e., the "pre-1988 reserves").[5] Thus, a thrift institution that is treated as a large bank generally is required to recapture its post-1987 additions to its bad debt reserves, whether such additions are made pursuant to the percentage of taxable income method or the experience method. The timing of this recapture may be delayed for a one- or two-year period to the extent the residential loan requirement described below applies.

In the case of a thrift institution that becomes a "small bank" (as determined under sec. 585(c)(2)), the amount of the institution's applicable excess reserves will be the excess of (1) the balance of its reserves described in section 593(c)(1) as of the close of its last taxable year beginning before January 1, 1996, over (2) the greater of the balance of: (a) its pre-1988 reserves or (b) what the institution's reserves would have been at the close of its last taxable year beginning before January 1, 1996, had the institution always used the experience method described in section 585(b)(2)(A) (i.e., the six-year average method). For purposes of the future application of section 585, the beginning balance of the small bank's reserve for its first taxable year beginning after December 31, 1995, will be the greater of the two amounts described in (2) in the preceding sentence, and the balance of the reserve at the close of the base year (for purposes of sec. 585(b)(2)(B)) will be the amount of its pre-1988 reserves. The residential loan requirement described below also applies to small banks. If such small bank later becomes a large bank, any section 481(a) adjustment amount required to be taken

[4] The provisions of the bill will apply to a thrift institution that has a taxable year that begins after December 31, 1995, even if such taxable year is a short taxable year that comes to a close because the thrift institution is acquired by a non-thrift institution.

In addition, a thrift institution that uses a reserve method described in section 593 will be deemed to have changed its method of computing reserves for bad debts even though such institution will be allowed to use the reserve method of section 585. Similarly, a large thrift institution will be deemed to have changed its method of computing reserves for bad debts even through such institution used the experience-method portion of section 593 in lieu of the percentage-of-taxable-income method of section 593.

[5] The balance of a taxpayer's pre-1988 reserves is reduced if the taxpayer's loan portfolio had decreased since 1988. The permitted balance of a taxpayer's pre-1988 reserves is reduced by multiplying such balance by the ratio of the balance of the taxpayer's loans outstanding at the close of the last taxable beginning before 1996, to the balance of the taxpayer's loans outstanding at the close of the last taxable beginning before 1988. This reduction is required for both large and small banks.

into account under section 585(c)(3) will not include any portion of the bank's pre-1988 reserve. Similarly, if the bank elects the cut-off method to implement its conversion to large bank status, the amount of the reserve against which the bank charges its actual losses will not include any portion of the bank's pre-1988 reserve and the amount by which the pre-1988 reserve exceeds actual losses will not be included in gross income.

The balance of the pre-1988 reserves is subject to the provisions of section 593(e), as modified by the bill (requiring recapture in the case of certain excess distribution to, and redemptions of, shareholders. Thus, section 593(e) will apply to an institution regardless of whether the institution becomes a commercial bank or remains a thrift institution. In addition, the balances of the pre-1988 reserve and the supplemental reserve will be treated as tax attributes to which section 381 applies. The Committee expects that Treasury regulations will provide rules for the application of section 593(e) in the case of mergers, acquisitions, spin-offs, and other reorganizations of thrift and other institutions.[6] The Committee believes that any such regulation should provide that, if the stock of an institution with a pre-1988 reserve is acquired by another depository institution, the pre-1988 reserve will not be restored to income by reason of the acquisition. Similarly, if an institution with a pre-1988 reserve is merged or liquidated tax-free into a bank, the pre-1988 reserve should not be restored to income by reason of the merger or liquidation. Rather, the bank will inherit the pre-1988 reserve and the post-1951 earnings and profits of the former thrift institution and section 593(e) will apply to the bank as if it were a thrift institution. That is, the pre-1988 reserve will be restored into income in the case of any distribution in redemption of the stock of the bank or in partial or complete liquidation of the bank following the merger of liquidation. In the case of any other distribution, the pre-1988 reserve will not be restored to income unless the distribution is in excess of the sum of the post-1951 earnings and profits inherited from the thrift institution and the post-1913 earnings and profits of the acquiring bank.[7] The Committee expects that Treasury regulations will address the case where the shareholders of an institution with a pre-1988 reserve are "cashed out" in a taxable merger of the institution and a bank. Such regulations may provide that the pre-1988 reserve may be restored to income if such redemption represents a concealed distribution from the former thrift institution. For example, cash received by former thrift shareholders pursuant to a taxable reverse merger may represent a concealed distribution if, immediately preceding the merger, the acquiring bank had no available resources to distribute and

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[6] The Committee expects that in the case of the merger, acquisition, spin-off, or other reorganization involving only thrift institutions, section 593(e) as modified by the bill, will continue to be applied in a manner similar to the way section 593(e) is applied under present law. However, guidance will be needed in the case of transactions where one of the parties to the transaction is not a thrift institution. For example, the issue of whether section 593(e) applies in the case where a thrift institution is merged into a bank generally does not arise under present law because such merger results in a charter change and, under proposed Treasury regulations, requires full bad debt reserve recapture.

[7] If the acquiring bank is a former thrift institution itself and the pre-1988 reserves of neither institution are restored to income pursuant to the merger, the Committee expects that the pre-1988 reserves and the post-1951 earnings and profits of the two institutions will be combined for purposes of the continued application of section 593(e) with respect to the combined institution.

its existing debt structure, indenture restrictions, financial condition, or regulatory capital requirements precluded it from borrowing money for purposes of making the cash payment to the former thrift shareholders. No inference is intended by the Committee as to the application of section 593(e) to these and similar transactions under present law.

Further, if a taxpayer no longer qualifies as a bank (as defined by sec. 581), the balances of the taxpayer's pre-1988 reserve and supplemental reserves are restored to income ratably over a six-year period, beginning in the taxable year the taxpayer no longer qualifies as a bank.

Residential loan requirement.—Under a special rule, if the taxpayer meets the "residential loan requirement" for a taxable year, the recapture of the applicable excess reserves otherwise required to be taken into account as a section 481(a) adjustment for such year will be suspended. A taxpayer meets the residential loan requirement if, for the taxable year, the principal amount of residential loans made by the taxpayer during the year is not less than its base account. The residential loan requirement is applicable only for taxable years that begin after December 31, 1995, and before January 1, 1998, and must be applied separately with respect to each such year. Thus, all taxpayers are required to recapture their applicable excess reserves within six, seven or eight years after the effective date of the provision.

The "base amount" of a taxpayer means the average of the principal amounts of the residential loans made by the taxpayer during the six most recent taxable years beginning before January 1, 1996. At the election of the taxpayer, the base amount may be computed by disregarding the taxable years within that six-year period in which the principal amounts of loans made during such years were highest and lowest. This election must be made for the first taxable year beginning after December 31, 1995, and applies to the succeeding taxable year unless revoked with the consent of the Secretary of the Treasury or his delegate.

For purposes of the residential loan requirement, a loan will be deemed to be "made" by a financial institution to the extent the institution is, in fact, the principal source of the loan financing. Thus, any loan only can be "made" once. The Committee expects that loans "made" by a financial institution may include, but are not limited to, loans (1) originated directly by the institution through its place of business or its employees, (2) closed in the name of the institution, (3) originated by a broker that acts as an agent for the institution, and (4) originated by another person (other than a financial institution) and that are acquired by the institution pursuant to a pre-existing, enforceable agreement to acquire such loans. In addition, Treasury regulations also may provide that loans "made" by a financial institution may include loans originated by another person (other than a financial institution) acquired by the institution soon after origination if such acquisition is pursuant to a customary practice of acquiring such loans from such person. A loan acquired by a financial institution from another financial institution generally will be considered to be made by the transferor rather than the transferee of the loan; however, such loan may be completely disregarded if a principal purpose of the transfer was to

allow the transferor to meet the residential loan requirement. A loan may be considered to be made by a financial institution even if such institution has an arrangement to transfer such loan to the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

For purposes of the residential loan requirement, a "residential loan" described in section 7701(a)(19)(C)(v) (generally, loans secured by residential real and church property and certain mobile homes),[8] but only to the extent the loan is made to the owner of the property to acquire, construct, or improve the property. Thus, mortgage refinancings and home equity loans are not considered to be residential loans, except to the extent the proceeds of the loan are used to acquire, construct, or improve qualified residential real property. The Committee understands that pursuant to the Home Mortgage Disclosure Act, financial institutions are required to disclose the purpose for which loans are made. The Committee further understands that for purposes of this disclosure, institutions are required to classify loans as home purchase loans, home improvement loans, refinancings, and multifamily dwelling loans (whether for purchase, improvement or refinancing of such property). The Committee expects that taxpayers (and the Secretary of the Treasury in promulgating guidance) may take such reporting into account, and make such adjustments as are appropriate,[9] in determining: (1) whether or not a loan qualifies as a "residential loan" and (2) whether the institution "made" the loan. A taxpayer must use consistent standards for determining whether loans qualify as residential loans made by the institution both for purposes of determining its base amount and for purposes of determining whether it met the residential loan requirement for a taxable year.

The residential loan requirement is determined on a controlled group basis. Thus, for example, if a controlled group consists of two thrift institutions with applicable excess reserves that are wholly-owned by a bank, the residential loan requirement will be met (or not met) with respect to both thrift institutions by comparing the principal amount of the residential loans made by all three members of the group during the taxable year to the group's base amount. The group's base amount will be the average principal amount of residential loans made by all three members of the group during the base period. The election to disregard the high and low taxable years during the 6-year base period also would be applied on a controlled group basis (i.e., generally by treating the members of the group as one taxpayer so that all members of the group must join in the election, and the same corresponding years of each member would be so disregarded).

Treasury regulations may provide rules for the application of the residential loan requirement in the case of mergers, acquisitions,

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[8] For this purpose, as under present law, if a multifamily structure securing a loan is used in part for nonresidential purposes, the entire loan will be deemed a residential real property loan if the planned residential use exceeds 80 percent of the property's planned use (determined as of the time the loan is made). In addition, loans made to finance the acquisition or development of land will be deemed to be loans secured by an interest in residential real property if, under regulations prescribed by the Secretary of the Treasury, there is a reasonable assurance that the property will become residential real property within a period of three years from the date of acquisition of the land.

[9] For example, adjustments will be required with respect to the reporting of multifamily dwellings in order to distinguish home purchase, home improvement, and refinancing loans.

and other reorganizations of thrift and other institutions. For example, the balance of a taxpayer's applicable excess reserve will be treated as a tax attribute to which section 381 applies. Thus, if an institution with an applicable excess reserve is acquired in a tax-free reorganization, the Committee expects that balance of such reserve will not be immediately restored to income but will continue to be subject to the residential loan requirement in the hands of the acquirer. The Committee further expects that if a financial institution joins or merges into (or leaves) a group of financial institutions, the base amount of the acquiring (or remaining) group will be appropriately adjusted to reflect the base amount of the acquired (or departing) institution for purposes of determining whether the group meets the residential loan requirement for the year of the acquisition (or departure) and subsequent years. Similarly, if a controlled group of institutions had made an election to disregard its high and low years in computing its base amount, it is anticipated that such election shall be binding on any institution that subsequently joins the group and the election shall be applied to the new member by disregarding the high and low years of the new member even if such years do not correspond to the years applicable to the other members of the group.

Treatment of conversions to credit unions

The bill provides that if a thrift institution to which the repeal of section 593 applies becomes a credit union, the credit union will be treated as an institution that is not a bank and any section 481(a) adjustment required to be included in gross income will be treated as derived from an unrelated trade or business. Thus, if a thrift institution becomes a credit union in its first taxable year beginning after December 31, 1995, the entire balance of the institution's bad debt reserve will be included in income, and subject to tax, over a six-year period beginning with such taxable year. No inference is intended as to the Federal income tax treatment of any other aspect of the conversion of a financial institution to a credit union.

Effective date

The repeal of section 593 is effective for taxable years beginning after December 31, 1995. The repeal of section 595 is effective for property acquired in taxable years beginning after December 31, 1995. The amendment to section 860E does not apply to any residual interest in a REMIC held by the taxpayer on October 31, 1995, and at all times thereafter.

The amendment to section 593(e)(1)(B) does not apply to any distributions with respect to preferred stock (including redemptions of such stock) if: (1) such stock was issued and outstanding as of November 1, 1995, and at all times thereafter before the distribution and (2) such distribution is made within the later of (a) one year after the date of enactment of this Act or (b) if the stock is redeemable by the issuer or a related party, 30 days after the date such stock first may be redeemed. For this purpose, the first date a preferred stock may be redeemed is the day upon which the issuer or a related party has the right to call the stock, regardless of the amount of call premium.

2. DEPRECIATION UNDER THE INCOME FORECAST METHOD (SEC. 402 OF THE BILL AND SEC. 167 OF THE CODE)

Present law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and is allowed to recover such cost over time through allowances for depreciation or amortization. Depreciation allowances for tangible property generally are determined under the modified Accelerated Cost Recovery System ("MACRS") of section 168, which provides that depreciation is computed by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Intangible property generally is amortized under section 197, which provides a 15-year recovery period and the straight-line method to the cost of applicable property.

Treatment of film, video tape, and similar property

MACRS does not apply to certain property, including any motion picture film, video tape, or sound recording or to other any property if the taxpayer elects to exclude such property from MACRS and the taxpayer applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197 does not apply to certain intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "standalone" basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost of such property may be determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property.

The "income forecast" method is an allowable method for calculating depreciation under section 167 for certain property. Under the income forecast method, the depreciation deduction for a taxable year for a property is determined by multiplying the cost of the property [10] (less estimated salvage value) by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income to be derived from the property during its useful life. The income forecast method has been held to be applicable for computing depreciation deductions for motion picture films, television films and taped shows, books, patents, master sound record-

[10] In *Transamerica Corp.* v. *U.S.*, 999 F.2d 1362, (9th Cir. 1993), the Ninth Circuit overturned the District Court and held that, for purposes of applying the income forecast method to a film, the "cost of a film" includes "participation" and "residual" payments (i.e., payments to producers, writers, directors, actors, guilds, and others based on a percentage of the profits from the film) even though these payments were contingent on the occurrence of future events. It is unclear to what extent, if any, the *Transamerica* decision applies to amounts incurred after the enactment of the economic performance rules of Code section 461(h), as contained in the Deficit Reduction Act of 1984.

ing and video games.[11] The total forecasted or estimated income to be derived from a property is to be based on the conditions known to exist at the end of the period for which depreciation is claimed. This estimate can be revised upward or downward at the end of a subsequent taxable period on additional information that becomes available after the last prior estimate. These revisions, however, do not affect the amount of depreciation claimed in a prior taxable year.

In the case of a film, income to be taken into account under the income forecast method means income from the film less the expense of distributing the film, including estimated income from foreign distribution or other exploitation of the film.[12] In the case of a motion picture released for theatrical exhibition, income does not include estimated income from future television exhibition of a film (unless an arrangement for domestic television exhibition has been entered into before the film has been depreciated to its reasonable salvage value). In the case of a series or a motion picture produced for television exhibition, income does not include estimated income from domestic syndication of a series or the film (unless an arrangement for syndication has been entered into before the series or film has been depreciated to its reasonable salvage value).[13] The Internal Revenue Service also has ruled that income does not include net merchandising revenue received from the exploitation of film characters.[14]

Reasons for change

The Committee believes that, in theory, the income forecast method is an appropriate method for matching the capitalized cost of certain property with the income produced by such property. However, the Committee believes that the application of the income forecast method under present law does not meet the theoretical objective. In addition, the Committee recognizes that the reliance of the operation of the income forecast method upon estimated income may result in a mismatch between income and depreciation deductions when future income is over- or under-estimated. The Committee bill attempts to address these issues.

Explanation of provision

The bill makes several amendments to the income forecast method of determining depreciation deductions.

Determinations of estimated income

First, the bill provides that income to be taken into account under the income forecast method includes all estimated income

[11] See, e.g., Rev. Rul. 60–358, 1960–2 C.B. 68; Rev. Rul. 64–273, 1964–2 C.B. 62; Rev. Rul. 79–285, 1979–2 C.B. 91; and Rev. Rul. 89–62, 1989–1 C.B. 78. Conversely, the courts have held that certain tangible personal property was not of a character to which the income forecast method was applicable. See, e.g., *ABC Rentals of San Antonio* v. *Comm.*, 68 TCM 1362 (1994) (consumer durable property subject to short-term, "rent-to-own" leases not eligible) and *Carland, Inc.* v. *Comm.*, 90 T.C. 505 (1988), affd. on this issue, 909 F.2d 1101 (8th Cir. 1990) railroad rolling stock subject to a lease not eligible).

[12] Rev. Rul. 60–358, 1960–2 C.B. 68.

[13] Rev. Proc. 71–29, 1971–2 C.B. 568.

[14] Private letter ruling 7918012, January 24, 1979. Private letter rulings do not have precedential authority and may not be relied upon by any taxpayer other than the taxpayer receiving the ruling but are some indication of IRS administrative practice.

generated by the property. In applying this rule, a taxpayer generally need not take into account income expected to be generated after the close of the tenth taxable year after the year the property was placed in service. In the case of a film, television show, or similar property, such income includes, but is not necessarily limited to, income from foreign and domestic theatrical, television, and other releases and syndications; and video tape releases, sales, rentals, and syndications.

Pursuant to a special rule, in the case of television and motion picture films, the income from the property shall include income from the financial exploitation of characters, designs, scripts, scores, and other incidental income associated with such films, but only to the extent the income is earned in connection with the ultimate use of such items by, or the ultimate sale of merchandise to, persons who are not related to the taxpayer (within the meaning of sec. 267(b)). As an example of this special rule, assume a taxpayer produces a motion picture the subject of which is the adventures of a newly-created fictional character. If the taxpayer produces dolls or T-shirts using the character's image, income from the sales of these products by the taxpayer to consumers would be taken into account in determining depreciation for the motion picture under the income forecast method. Similarly, if the taxpayer enters into any licensing or similar agreement with an unrelated party with respect to the use of the image, such licensing income would be taken into account in determining depreciation for the motion picture. However, if the taxpayer uses the character's image to promote a ride at an amusement park that is wholly-owned by the taxpayer, no portion of the admission fees for the amusement park are to be taken into account under the income forecast method with respect to the motion picture.

In addition, pursuant to another special rule, if a taxpayer produces a television series and initially does not anticipate syndicating the episodes from the series, the forecasted income for the episodes of the first three years of the series need not take into account any future syndication fees (unless the taxpayer enters into an arrangement to syndicate such episodes during such period).

The 10th-taxable-year rule, the financial exploitation rule, and the syndication rule apply for purposes of the look-back method described below.

Determination and treatment of costs of property

The adjusted basis of property that may be taken into account under the income forecast method only will include amounts that satisfy the economic performance standard of section 461(h).[15] For this purpose, if the taxpayer incurs a noncontingent liability to acquire property subject to the income forecast method from another person, economic performance will be deemed to occur with respect to such noncontingent liability when the property is provided to the taxpayer. In addition, the recurring item exception of section 461(h)(3) will apply in a manner similar to the way such exception applies under present law. Thus, expenditures that relate to an

[15] No inference is intended as to the proper application of section 461(h) to the income forecast method under present law.

item of property that are incurred in the taxable year following the taxable year in which the property is placed in service may be taken into account in the year the property is placed in service to the extent such expenditures meet the recurring item exception for such year.

Any costs that are taken into account after the property is placed in service are treated as a separate piece of property to the extent (1) such amounts are significant and are expected to give rise to a significant increase in the income from the property that was not included in the estimated income from the property, or (2) such costs are incurred more than 10 years after the property was placed in service. To the extent costs are incurred more than 10 years after the property was placed in service and give rise to a separate piece of property for which no income is generated, such costs may be written off and deducted they are incurred. For example, assume a taxpayer places a property subject to the income forecast method in service during a taxable year and all income from the property is generated in the following four-year period. If the taxpayer incurs additional costs with respect to that property more than 10 years later (e.g., a payment pursuant to a deferred contingent compensation arrangement to a person that produced the property), such costs may be deducted in the year incurred provided no more income is generated with respect to such costs or the original property.

Any costs that are not recovered by the end of the tenth taxable year after the property was placed in service may be taken into account as depreciation in such year.

Look-back method

Finally, taxpayers that claim depreciation deductions under the income forecast method are required to pay (or would receive) interest based on the recalculation of deprecation under a "look-back" method.[16] The "look-back" method is applied in any "recomputation year" by (1) comparing depreciation deductions that had been claimed in prior periods to depreciation deductions that would have been claimed had the taxpayer used actual, rather than estimated, total income from the property; (2) determining the hypothetical overpayment or underpayment of tax based on this recalculated depreciation, and (3) applying the overpayment rate of section 6621 of the Code.

Except as provided in Treasury regulations, a "recomputation year" is the third and tenth taxable year after the taxable year the property was place in service, unless the actual income from the property for each taxable year ending with or before the close of such years was within 10 percent of the estimated income from the property for such years. The Secretary of the Treasury has the authority to allow a taxpayer to delay the initial application of the look-back method where the taxpayer may be expected to have significant income from the property after the third taxable year after the taxable year the property was placed in service (e.g., the Treas-

[16] The "look-back" method of the provision resembles the look-back method applicable to long-term contracts accounted for under the percentage-of-completion method of present-law sec. 460.

ury Secretary may exercise such authority where the depreciable life of the property is expected to be longer than three years).

In applying the look-back method, any cost that is taken into account after the property was placed in service may be taken into account by discounting (using the Federal mid-term rate determined under sec. 1274(d) as of the time the costs were taken into account) such cost to its value as of the date the property was place in service.

Property that had an unadjusted basis of $100,000 or less is not subject to the look-back method. For this purpose, "unadjusted basis" means the total capitalized cost of a property as of the close of a recomputation year.

The provision provides a simplified look-back method for pass-through entities.

Effective date

The provision is effective for property placed in service after September 13, 1995, unless produced or acquired pursuant to a binding written contract in effect on such date and all times thereafter. For this purpose, the binding contract exception may apply to a written contract in effect on the relevant dates if that contract binds a taxpayer to produce property that will be used by the other party to the contract once the property is produced.

The provision may apply to property place in service in taxable years that ended before the date of enactment of this Act. The provision waives additions to tax imposed under sections 6654, 6655, and 6662(d) for any underpayments of tax or estimated tax for any taxable year ending before the date of enactment of this Act to the extent the underpayment was created or increased by the changes made to the income forecast method of depreciation by the provision. The application of the provision (including the look-back method) is not waived for any taxable year that ends after the date of enactment of this Act.

III. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of the bill as reported.

ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS OF H.R. 3286, THE "ADOPTION PROMOTION AND STABILITY ACT OF 1996," AS REPORTED BY THE COMMITTEE ON FINANCE, FISCAL YEARS 1996–2005

[In millions of dollars]

Provision	Effective	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	1996–00	2001–05	1996–05
1. $5,000 credit and exclusion for employer-provided assistance for regular adoption expenses, $6,000 for special needs adoptions; sunset employer assistance exclusion and non-special needs credit after 2000.	tyba 12/31/96	....	−33	−329	−351	−375	−342	−108	−108	−104	−101	−1,088	−762	−1,850
2. Repeal section 593–deduction for bad debt reserves for thrift institutions.	tyba 12/31/95	47	111	216	280	277	272	260	247	111	36	931	926	1,857
3. Corporate accounting—reform of income forecast method.	ppisa 9/13/95	32	69	29	13	14	16	19	22	28	31	157	116	273
Net totals	....	79	147	−84	−58	−84	−54	171	161	35	−34	....	280	280

Note: Details may not add to totals due to rounding.
Legend for "Effective" column: ppisa = property placed in service after, tyba = taxable years beginning after.

Source: Joint Committee on Taxation.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the revenue provisions of the bill as reported involve no new or increased budget authority. Title II (interethnic adoptions) will have a negligible effect on budget outlays and budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the adoption credit and exclusion provisions of Title I involve new tax expenditures (see revenue table in Part III. A., above), and that the revenue offset provisions of Title IV involve reduced tax expenditures (see Part III, A., above).

C. Consultation with Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not yet submitted a statement on this bill at the time of filing this report.

IV. VOTE OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the vote on the motion to report the bill. The bill (H.R. 3286) was ordered favorably reported, as amended by the Chairman's proposed substitute amendment to Titles I, II, and IV, by unanimous voice vote on June 12, 1996. A quorum was present for the vote. (The bill is to be referred to the Senate Committee on Indian Affairs for a period of 10 legislative days for consideration of Title III of the bill.)

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the bill as reported.

Impact on individuals and businesses

Title I of the bill as reported provides for a new tax credit and exclusion for certain adoption expenses. This will defray part of the cost of adoption. There is a $5,000 per child limit on the credit and exclusion ($6,000 for adoption of a special needs child).

Title II of the bill will remove bureaucratic barriers to interethnic adoptions by providing that not later than January 1, 1997, States receiving funds from the Federal Government for adoption or foster care placements may not deny any person the opportunity to become an adoptive or foster parent on the basis of race, color, or national origin of the person or of the child, nor may the State delay or deny the placement of a child for adoption or into foster care on the basis of race, color, or national origin of the adoptive

or foster parent or of the child. Noncompliance with Title II of the bill would constitute a violation of Title VI of the Civil Rights Act of 1964.

The Committee action does not address Title III of the bill (relating to Indian child custody and adoptions).

Title IV provides two revenue offsets for the bill: (1) repeal of Code section 593 reserve method of accounting for bad debts by thrift institutions and (2) revision of the income forecast method of determining depreciation deductions.

Impact on personal privacy and paperwork

The revenue provisions of the bill (Titles I and IV) will have little, if any, impact on personal privacy and little impact on taxpayer paperwork. The adoption tax credit will cause individual taxpayers to keep track of all eligible adoption expenses for the credit.

B. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Public Law 104–4).

The Committee has determined that two of the revenue provisions of the bill contain Federal mandates on the private sector: (1) The provision relating to treatment of bad debt deductions of thrift institutions (repeal of Internal Revenue Code section 593); and (2) the provision to reform the income forecast method of accounting. In general, the first provision repeals a special rule regarding the treatment of bad debt reserves by thrift institutions and conforms the treatment of such reserves to the manner in which such reserves are required to be treated by banks. The second provision makes several changes to the income forecast method of determining depreciation deductions. These provisions will increase the Federal tax liabilities of certain taxpayers.

The cost required to comply with each mandate generally is no greater than the revenue estimate for the provision. Benefits from the provisions include improved administration of the Federal income tax laws and a more accurate measurement of gross income for Federal income tax purposes. The Committee believes that the benefits of the provisions are greater than the cost required to comply with the mandates.

The provision relating to bad debt reserves of thrift institutions corrects a present-law provision that results in a mismeasurement of economic income and provides thrift institutions with a tax benefit not provided to similarly situated depository institutions. The provision to reform the income forecast method of accounting results in a better matching between income and depreciation deductions with respect to certain types of depreciable property.

These revenue-raising provisions are used to offset the cost of providing a tax credit to individuals who adopt a child. This tax credit furthers the social policy goal of ensuring that families who desire to adopt a child have the financial resources to do so. The revenue-raising provisions are critical to achieving this goal.

The revenue provisions of the bill do not contain any intergovernmental mandates.

The revenue-raising provisions of the bill affect activities that are only engaged in by the private sector and, thus, do not affect the

competitive balance between State, local, or tribal governments and the private sector. Because the adoption tax credit and exclusion for employer-provided adoption expenses provide a larger benefit in the case of special needs adoptions, it may encourage more adoptions through State or local agencies and thus affect the competitive balance between State, local, or tribal governments and the private sector.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).