107TH CONGRESS
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DESCRIPTION OF THE ECONOMIC RECOVERY AND ASSISTANCE FOR AMERICAN WORKERS ACT OF 2001

TECHNICAL EXPLANATION OF PROVISIONS
APPROVED BY THE COMMITTEE ON
NOVEMBER 8, 2001

COMMITTEE ON FINANCE
UNITED STATES SENATE

MAX BAUCUS, *Chairman*

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I. SUPPLEMENTAL REBATE FOR INDIVIDUAL TAXPAYERS

(Sec. 101 of the bill and Sec. 6428 of the Code)

PRESENT LAW

The Economic Growth and Tax Relief Reconciliation Act of 2001 provided for a rate reduction credit for 2001. The credit is computed in the following manner. Taxpayers are entitled to a credit in tax year 2001 of 5 percent (the difference between the 15-percent rate and the 10-percent rate) of the amount of income that would have been eligible for the new 10-percent rate. Taxpayers may not receive this credit in excess of their income tax liability (determined after nonrefundable credits).

Most eligible taxpayers have received this credit in the form of a check issued by the Department of the Treasury. The amount of the check was computed in the same manner as the credit, except that it was done on the basis of tax returns filed for 2000 (instead of 2001).

On their tax returns for 2001, taxpayers will reconcile the amount of the credit with the check they receive in the following manner. They will complete a worksheet calculating the amount of the credit based on their 2001 tax return. They will then subtract from the credit the amount of the check they received. For many taxpayers, these two amounts will be the same. If, however, the result is a positive number (because, for example, the taxpayer paid no tax in 2000 but is paying tax in 2001), the taxpayer may claim that amount as a credit against 2001 tax liability. If, however, the result is negative (because, for example, the taxpayer paid tax in 2000 but owes no tax for 2001), the taxpayer is not required to repay that amount to the Treasury. Otherwise, the checks have no effect on tax returns filed in 2001; the amount is not includible in gross income and it does not otherwise reduce the amount of withholding. In no event may the Department of the Treasury issue checks after December 31, 2001. This is designed to prevent errors by taxpayers who might claim the full amount of the credit on their 2001 tax returns and file those returns early in 2002, at the same time the Treasury check might be mailed to them. Payment of the credit (or the check) is treated, for all purposes of the Code,[1] as a payment of tax. As such, the credit or the check is subject to the refund offset provisions, such as those applicable to past-due child support under section 6402 of the Code.

In general, taxpayers eligible for the credit (and the check) are individuals other than estates or trusts, nonresident aliens, or dependents. The determination of this status for the relevant year is made on the basis of the information filed on the tax return.

[1] A special rule provides that no interest will be paid with respect to the checks.

REASONS FOR CHANGE

The Committee believes that providing supplemental rebates will provide further stimulus to the economy.

EXPLANATION OF PROVISION

The bill provides a new supplemental rebate. Individuals who filed income tax returns for 2000[2] (regardless of whether they had any income tax liability, any payroll tax liability, or showed any amount as wages) are eligible for this supplemental rebate. The amount of the rebate is calculated in the following manner: taxpayers are eligible for the maximum rebate amount for their filing status ($300 single or married filing separately, $500 head of household, $600 joint filers) minus the amount (if any) of any previous rebate check issued. Thus, for example, if a single person received $100 earlier this year as her rate reduction credit, she will receive an additional $200 as a supplemental rebate. Those taxpayers who earlier received the full amount for their filing status will receive no supplemental rebates.

Dependents and nonresident aliens generally are ineligible for the supplemental rebates (as they were for the previous rebates).[3] The Committee expects that the IRS will send notices to affected taxpayers explaining the computation of their supplemental rebate amounts and how the taxpayer should properly complete the rebate reconciliation schedule contained in the tax return forms package.

The bill makes a technical correction to EGTRA 2001 to provide that the rate reduction credit enacted by that Act is treated as a nonrefundable personal credit. The correction thus allows the rate reduction credit prior to determining the amount of the refundable child credit or the amount of the carryovers of other nonrefundable personal credits, such as the adoption credit.

Residents of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands who filed income tax returns with those jurisdictions for 2000 (regardless of whether they had any income tax liability, any payroll tax liability, or showed any amount as wages) are also eligible for this supplemental rebate. The amount of the rebate is calculated in the same manner as described above. Any such residents who may have filed an income tax return for 2000 with both the United States and one (or more) of these jurisdictions may only receive in total the maximum rebate amount ($300, $500, or $600 depending on filing status as described above). The governments of these jurisdictions are required to provide to the IRS the names, addresses, and taxpayer identification numbers of eligible residents so that the IRS can authorize the issuance of these supplemental rebates. This information will have to be provided in the manner specified by the IRS.

[2] Taxpayers who did not file an income tax return for 2000 but who do file an income tax return for 2001 will continue to be eligible for the rate reduction credit previously enacted, the amount of which is dependent upon the amount of income subject to the 10-percent rate. They are not, however, eligible for this supplemental rebate.

[3] Some nonresident aliens may, however, be eligible for the supplemental rebates described in the last paragraph.

EFFECTIVE DATE

The proposal is effective on the date of enactment. The notice informing U.S. taxpayers of the amount of their supplemental rebates is required to be issued, to the maximum extent feasible, by December 25, 2001.[4] In order to prevent difficulties that could arise in the simultaneous administration of two rebate provisions, the issuance of checks under the previous rebate provision is required to cease on the date of enactment of the supplemental rebate.

II. TEMPORARY BUSINESS RELIEF PROVISIONS

A. Special Depreciation Allowance for Certain Property

(Sec. 201 of the bill and Sec. 168 of the Code)

PRESENT LAW

Depreciation deductions

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS"). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

Section 280F limits the annual depreciation deductions with respect to passenger automobiles to specified dollar amounts, indexed for inflation.

Section 167(f)(1) provides that capitalized computer software costs, other than computer software to which section 197 applies, are recovered ratably over 36 months.

Section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents is eligible to be recovered using the income forecast method of depreciation. Under the income forecast method, a property's depreciation deduction for a taxable year is determined by multiplying the cost of the property 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.

[4] This requirement is inapplicable to notices sent to residents of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands who filed income tax returns with those jurisdictions for 2000, because it is not possible for those jurisdictions to provide the information to the IRS and for the IRS to process the information sufficiently rapidly for any of these notices to be issued by December 25, 2001.

Expensing election

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $24,000 (for taxable years beginning in 2001 or 2002) of the cost of qualifying property placed in service for the taxable year (sec. 179). This amount is increased to $25,000 for taxable years beginning in 2003 and thereafter. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $24,000 ($25,000 for taxable years beginning in 2003 and thereafter) amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.

REASONS FOR CHANGE

Allowing additional first-year depreciation will reduce the cost of capital and improve the after tax rate of return on capital investment. Consequently, the Committee believes it will promote capital investment, modernization, and growth, which will help spur an economic recovery.

EXPLANATION OF PROVISION

The provision allows an additional first-year depreciation deduction equal to 10 percent of the adjusted basis of certain qualified property that is placed in service before January 1, 2003. The additional depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.[5] The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

Property qualifies for the additional first-year depreciation deduction if the property is (1) property to which MACRS applies with an applicable recovery period of 20 years or less, (2) water utility property as defined in section 168(e)(5), (3) qualified leasehold improvement property,[6] (4) motion picture films, sound record-

[5] The additional depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A.

[6] 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) of that portion of the building, or by the lessor of that portion of the building. That portion of the building is to be occupied exclusively by the lessee (or any sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service.

ings, books, copyrights, and patents eligible for depreciation under section 167(g), or (5) computer software other than computer software covered by section 197. In order to be qualified property, the original use [7] of the property must commence with the taxpayer on or after September 11, 2001.[8] A special rule precludes the additional first-year depreciation deduction for property that is required to be depreciated under the alternative depreciation system of MACRS.

In addition, property qualifies only if acquired by the taxpayer (1) after September 10, 2001 and before September 11, 2002, and no binding written contract for the acquisition is in effect before September 11, 2001 or (2) pursuant to a binding written contract which was entered into after September 10, 2001, and before September 11, 2002. Finally, property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after September 10, 2001, and before September 11, 2002 (and all other requirements are met). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

The limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (sec. 280F of the Code) is increased in the first year by $1,600 for automobiles that qualify (and do not elect out of the increased first year deduction). The $1,600 increase is not indexed for inflation.

The following examples illustrate the operation of the provision.

> Example 1.—Assume that on March 1, 2002, a calendar year taxpayer acquires and places in service qualified property that costs $1 million. Under the provision, the taxpayer is allowed an additional first-year depreciation deduction of $100,000. The remaining $900,000 of adjusted basis is recovered in 2002 and subsequent years pursuant to the depreciation rules of present law.
>
> Example 2.—Assume that on March 1, 2002, a calendar year taxpayer acquires and places in service qualified property that costs $50,000. In addition, assume that the property qualifies

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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.

For purposes of the provision, a binding commitment to enter into a lease would be treated as a lease, and the parties to the commitment would be treated as lessor and lessee. A lease between related persons would not be considered a lease for this purpose. In addition, an improvement made by the person who was the lessor of the improvement when it was placed in service is treated as qualified leasehold improvement property only so long as that person owns the improvement.

[7] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. In addition, it is intended that additional capital expenditures incurred to recondition or rebuild property the original use of which began with the taxpayer would satisfy the "original use" requirement. See Treasury Regulation 1.48–2 Example 2. However, it is intended that additional capital expenditures incurred to recondition or rebuild property the original use of which did not begin with the taxpayer would not satisfy the "original use" requirement.

[8] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

for the expensing election under section 179. Under the provision, the taxpayer is first allowed a $35,000 deduction under section 179.[9] The taxpayer then is allowed an additional first-year depreciation deduction of $1,500 based on $15,000 ($50,000 original cost less the section 179 deduction of $35,000) of adjusted basis. Finally, the remaining adjusted basis of $13,500 ($15,000 adjusted basis less $1,500 additional first-year depreciation) is to be recovered in 2002 and subsequent years pursuant to the depreciation rules of present law.

EFFECTIVE DATE

The provision applies to property placed in service after September 10, 2001.

B. TEMPORARY INCREASE IN SECTION 179 EXPENSING

(Sec. 202 of the bill and Sec. 179 of the Code)

PRESENT LAW

Present law provides that, in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $24,000 (for taxable years beginning in 2001 or 2002) of the cost of qualifying property placed in service for the taxable year (sec. 179). This amount is increased to $25,000 of the cost of qualified property placed in service for taxable years beginning in 2003 and thereafter. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $24,000 ($25,000 for taxable years beginning in 2003 and thereafter) amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.

REASONS FOR CHANGE

The Committee believes that increasing the number of small businesses eligible for immediate expensing and increasing the amount allowed to be expensed will provide an incentive for eligible businesses to increase their investment in capital assets, thus promoting economic growth for small businesses.

EXPLANATION OF PROVISION

The provision provides that the maximum dollar amount that may be deducted under section 179 is increased to $35,000 for

[9] A subsequent provision in the bill increases the amount deductible in 2002 under section 179 to $35,000.

property placed in service in taxable years beginning after December 31, 2001, and before January 1, 2003.[10] The provision increases the present law $200,000 limit to $325,000. Thus, under the provision the $35,000 amount is reduced by the amount by which the cost of qualifying property placed in service exceeds $325,000. As under present law, no general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. For taxable years beginning after December 31, 2002, present law applies (i.e., up to a $25,000 deduction that is reduced by the amount of qualifying property placed in service by the taxpayer that exceeds $200,000).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2001.

C. Five-Year Carryback of Net Operating Losses

(Sec. 203 of the bill and Secs. 172 and 56 of the Code)

PRESENT LAW

A net operating loss ("NOL") is, generally, the amount by which a taxpayer's allowable deductions exceed the taxpayer's gross income. A carryback of an NOL generally results in the refund of Federal income tax for the carryback year. A carryforward of an NOL reduces Federal income tax for the carryforward year.

In general, an NOL may be carried back two years and carried forward 20 years to offset taxable income in such years. Different rules apply with respect to NOLs arising in certain circumstances. For example, a three-year carryback applies with respect to NOLs (1) arising from casualty or theft losses of individuals, or (2) attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business. A five-year carryback period applies to NOLs from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area). Special rules also apply to real estate investment trusts (no carryback), specified liability losses (10-year carryback), and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction).

The alternative minimum tax rules provide that a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than 90 percent of the AMTI.

REASONS FOR CHANGE

The NOL carryback and carryforward rules allow taxpayers to smooth out swings in business income (and Federal income taxes thereon) that result from business cycle fluctuations and unexpected financial losses. The current uncertain economic conditions have resulted in many taxpayers incurring unexpected financial losses. A temporary extension of the NOL carryback period will

[10] As a result of the incresed deduction, the maximum dollar amount that may be deducted by an enterprise zone business or a renewal community business is increased to $70,000 for taxable years beginning after December 31, 2001, and before January 1, 2003. See sec. 1397A and sec. 1400J.

provide taxpayers in all sectors of the economy who experience such losses the ability to increase cash flow through the refund of income taxes paid in prior years. The provision will free up funds that can be used for capital investment or other expenses that will provide stimulus to the economy. In addition, a greater ability to use current losses will enable more taxpayers to take advantage of the additional first-year depreciation provision and thus enhance the stimulative effect of these provisions.

EXPLANATION OF PROVISION

The provision temporarily extends the general NOL carryback period to five years (from two years) for NOLs arising in any taxable year ending in year 2001.[11] The five-year carryback period also applies to NOLs during this period that qualify under present law for a three-year carryback period (i.e., NOLs arising from casualty or theft losses of individuals or attributable to certain Presidentially declared disaster areas).

In addition, the provision allows an NOL deduction attributable to any taxable year ending in 2001 to offset 100 percent of a taxpayer's AMTI in a carryback year.

A taxpayer can elect to forgo the five-year carryback period. The election to forgo the five-year carryback period will be made in the manner prescribed by the Secretary of the Treasury and will be made by the due date of the return (including extensions) for the year of the loss. The election is irrevocable. If a taxpayer elects to forgo the five-year carryback period, then the losses are subject to the rules that otherwise would apply under section 172 absent the provision.

EFFECTIVE DATE

The provision is effective for net operating losses generated in taxable years ending in 2001.

III. TAX INCENTIVES FOR NEW YORK CITY AND DISTRESSED AREAS

A. EXPANSION OF WORK OPPORTUNITY TAX CREDIT TARGETED CATEGORIES TO INCLUDE CERTAIN EMPLOYEES IN NEW YORK CITY

(Sec. 301 of the bill and Sec. 51 of the Code)

PRESENT LAW

In general

The work opportunity tax credit ("WOTC") is available on an elective basis for employers hiring individuals from one or more of

[11] The provision is not intended to affect the terms and conditions that the Internal Revenue Service may impose on a taxpayer seeking approval for a change in its annual accounting period. *See e.g.*, Rev. Proc. 2000–1 C.B. 309, sec. 5.06 ("If the corporation (or consolidated gorup) has a NOL (or consolidated NOL) in the short period required to effect the change, the NOL may not be carried back but must be carried over in accordance with the provisions of sec. 172 beginning with the first taxable year after the short period. However, the short period NOL (or consolidated NOL) is carried back or carried over in accordance with sec. 172 if it is either: (a) $50,000 or less, or (b) results from a short period of 9 months or longer and is less than the NOL (or the consolidated NOL) for a full 12-month period beginning with the first day of the short period.")

eight targeted groups. The credit equals 40 percent (25 percent for employment of less than 400 hours) of qualified wages. Generally, qualified wages are wages 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.

The maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). 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).

For purposes of the credit, wages are generally defined as under the Federal Unemployment Tax Act, without regard to the dollar cap.

Targeted groups eligible for the credit

The eight targeted groups are: (1) families eligible to receive benefits under the Temporary Assistance for Needy Families ("TANF") Program; (2) high-risk youth; (3) qualified ex-felons; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; (7) families receiving food stamps; and (8) persons receiving certain Supplemental Security Income ("SSI") benefits.

The employer's deduction for wages is reduced by the amount of the credit.

Expiration date

The credit is effective for wages paid or incurred to a qualified individual who begins work for an employer before January 1, 2002. Section 402 of the bill provides a one-year extension of the WOTC through December 31, 2002.

REASONS FOR CHANGE

The Committee believes that this provision will encourage a long-term commitment to the New York recovery zone by businesses currently located in the zone and those businesses that were forced to temporarily relocate outside of the zone. Further, the committee believes that it will attract some new businesses to the zone. The Committee believes that this temporary stimulus is necessary to offset any short-term disincentive to operate a business in the zone.

EXPLANATION OF PROVISION

The bill creates a new targeted group for the WOTC. The new targeted group is individuals employed by businesses located on or south of Canal street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan, New York, New York (the "New York Recovery Zone") or that relocated from the New York Recovery Zone elsewhere within New York City due to the destruction or damage of their workplaces within the New York Recovery Zone. Generally an employer can claim the credit for work performed in the New York Recovery Zone after September 10, 2001 and before January 1, 2003 by such qualified individuals. In the case of otherwise qualified businesses that relocated due to the destruction or damage of their workplaces, the credit can be claimed for work performed outside of the zone within the dates specified above. Unlike the other targeted categories, the credit for the new targeted group is available for wages paid to both new hires and existing employees. For each qualified business that relocated from the New York Recovery Zone elsewhere within New York City due to the destruction or damage of their workplaces within the New York Recovery Zone employer, the number of its employees whose wages are eligible under the new targeted category may not exceed the number of its employees in the New York Recovery Zone on September 11, 2001. Other qualified businesses (e.g., businesses that operate in the New York Recovery Zone both on and after Sept. 11, 2001 and businesses that move into the New York Recovery Zone after September 11, 2001) would not be subject to that limitation.

For the new category, the maximum credit is $4,800 (40 percent of $12,000 of qualified wages) per qualified employee in each taxable year.

The New York State Department of Labor will certify members of this new targeted group. In the case of existing employees or those who begin work for the employer before April 1, 2002, certifications must be submitted by May 1, 2002. In the case of new employees (i.e., those who begin work for the employer after March 31, 2002) within this category, the otherwise applicable certification rules will apply. It is contemplated that an additional form similar to Form 8850 may be necessary for this new targeted group.

The portion of each employer's WOTC credit attributable to the new targeted group will allowed against the alternative minimum tax.

The provision reduces the amount that would otherwise be available for disaster recovery activities and assistance related to the terrorist acts in New York City under the Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Acts on the United States (Public Law 107–38).

EFFECTIVE DATE

The provision is effective in taxable years ending after September 11, 2001 (for wages paid or incurred to qualified individuals for work after September 10, 2001 and before January 1, 2003).

B. Authorize Issuance of Tax-Exempt Private Activity Bonds for Rebuilding the Portion of New York City Damaged in the September 11, 2001, Terrorist Attack

(Sec. 302 of the bill)

PRESENT LAW

Rules governing issuance of tax-exempt bonds

In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (sec. 103). Interest on 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 a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called "private activity bonds."[12] The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

Private activities eligible for financing with tax-exempt private activity bonds

Present law includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities. Both capital expenditures and limited working capital expenditures of charitable organizations described in section 501(c)(3) of the Code ("qualified 501(c)(3) bonds") may be financed with tax-exempt bonds.

States or local governments may issue tax-exempt "exempt-facility bonds" to finance property for certain private businesses. Business facilities eligible for this financing include transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, local district heating or cooling, and hazardous waste disposal facilities); privately owned and/or operated low-income rental housing;[13] and certain private facilities for the local furnishing of electricity or gas. A further provision allows tax-exempt financing for "environmental enhancements of hydro-electric generating facilities." Tax-exempt financing also is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers ("qualified small-issue bonds"), local redevelopment activities ("qualified redevelopment bonds"), and eligible empowerment zone and enterprise community businesses.

Tax-exempt private activity bonds also may be issued to finance limited non-business purposes: certain student loans and mortgage loans for owner-occupied housing ("qualified mortgage bonds" and "qualified veterans' mortgage bonds"). Purchasers of houses financed with qualified mortgage bonds must be first-time homebuyers satisfying prescribed income limits, the purchase prices of the houses is limited, the amount by which interest rates charged to homebuyers may exceed the interest paid by issuers is restricted, and a recapture provision applies to target the benefit to purchasers having longer-term need for the subsidy provided by the bonds. Qualified veterans' mortgage bonds are not subject to these limitations, but these bonds may only be issued by five States and may only be used to finance mortgage loans to veterans who served on active duty before January 1, 1977.

With the exception of qualified 501(c)(3) bonds, private activity bonds may not be issued to finance working capital requirements of private businesses.

[12] Interest on private activity bonds (other than qualified 501(c)(3) bonds) is a preference item in calculating the alternative minimum tax.

[13] Residential rental projects must satisfy low-income tenant occupancy requirements for a minimum period of 15 years.

In most cases, the aggregate volume of tax-exempt private activity bonds that may be issued in a State is restricted by annual volume limits. These annual volume limits are equal to $62.50 per resident of the State, or $187.5 million if greater. The volume limits are scheduled to increase to the greater of $75 per resident of the State or $225 million in calendar year 2002. After 2002, the volume limits will be indexed annually for inflation.

Arbitrage restrictions on tax-exempt bonds

The Federal income tax does not apply to the income of States and local governments that is derived from the exercise of an essential governmental function. To prevent these tax-exempt entities from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than needed for the purpose of the borrowing, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds. 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, profits that are earned during these periods or on such investments must be rebated to the Federal Government. Governmental bonds are subject to less restrictive arbitrage rules that most private activity bonds.

Miscellaneous additional restrictions on tax-exempt bonds

Several additional restrictions apply to the issuance of tax-exempt bonds. First, private activity bonds (other than qualified 501(c)(3) bonds) may not be advance refunded. Governmental bonds and qualified 501(c)(3) bonds may be advance refunded one time. An advance refunding occurs when the refunded bonds are not retired within 90 days of issuance of the refunding bonds.

Issuance of private activity bonds is subject to restrictions on use of proceeds for the acquisition of land and existing property, use of proceeds to finance certain specified facilities, (e.g., airplanes, skyboxes, other luxury boxes, health club facilities, gambling facilities, and liquor stores) and use of proceeds to pay costs of issuance (e.g., bond counsel and underwriter fees). Additionally, the term of the bonds generally may not exceed 120 percent of the economic life of the property being financed and certain public approval requirements (similar to requirements that typically apply under State law to issuance of governmental debt) apply under Federal law to issuance of private activity bonds. Present law precludes substantial users of property financed with private activity bonds from owning the bonds to prevent their deducting tax-exempt interest paid to themselves. Finally, owners of most private-activity-bond-financed property are subject to special "change-in-use" penalties if the use of the bond-financed property changes to a use that is not eligible for tax-exempt financing while the bonds are outstanding.

"Bank carrying cost" exception

In general, costs incurred to purchase or carry tax-exempt bonds may not be deducted. Financial institutions are subject to a special rule that disallows a pro rata portion of the interest expense they incur if those institutions invest in tax-exempt bonds (other than certain bonds issued by governmental units that issue no more than $10 million of governmental bonds in the calendar year when the exempt bonds are issued).

REASONS FOR CHANGE

In light of the extraordinary economic circumstances resulting from the terrorist attacks of September 11, 2001, the Committee believes a limited expansion of tax-exempt bond authority to assist in rebuilding efforts in New York City is appropriate.

EXPLANATION OF PROVISION

In general

The provision authorizes issuance during calendar year 2002 of $15 billion of tax-exempt private activity bonds to finance the construction and rehabilitation of commercial [14] and residential rental [15] real property in a newly designated New York Recovery Zone ("Zone") of New York City.[16] Property eligible for financing with these bonds includes buildings and their structural components, fixed tenant improvements,[17] and public utility property (e.g., gas, water, electric and telecommunication lines). All business addresses located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan are considered to be located within the New York Recovery Zone.

If the government of New York City determines that it is not feasible to use all of the authorized bond proceeds for property located in the Zone, up to $7 billion of bond proceeds may be used for the construction and rehabilitation of commercial real property (including fixed tenant improvements) located outside the Zone and within New York City.[18] Bond-financed property located outside the Zone must meet the additional requirements that the project have at least 100,000 square feet of usable office or other commercial space in a single building or multiple adjacent buildings.

Bond authority that is not allocated to bonds issued during calendar year 2002 may be carried forward for a period of up to three years under rules similar to the rules governing carryforward of the State private activity bond volume limits.

[14] No more than 10 percent of the authorized bond amount may be used to finance property used for retail sales of tangible property (e.g., department stores, restaurants, etc.) and functionally related and subordinate property.

[15] No more than 20 percent of the authorized bond amount may be used to finance residential rental property.

[16] Current refundings of outstanding bonds issued under the provision do not count against the $15 billion volume limit to the extent that the principal amount of the refunding bonds does not exceed the outstanding principal amount of the bonds being refunded. The bonds cannot be advance refunded.

[17] Fixtures and equipment that could be removed from the designated zone for use elsewhere are not eligible for financing with these bonds.

[18] Public utility property and residential property located outside the Zone cannot be financed with the bonds.

Subject to the following exceptions and modifications, issuance of these tax-exempt bonds is subject to the general rules applicable to issuance of exempt-facility private activity bonds:

(1) Issuance of the bonds is not subject to the aggregate annual State private activity bond volume limits (sec. 146);

(2) The restriction on use of private activity bond proceeds to finance land acquisition is determined by reference to the $15 billion amount of bonds authorized under the provision rather than by reference to individual bond issues (sec. 147(c));

(3) The restriction on acquisition of existing property is applied using a minimum requirement of 50 percent of the cost of acquiring the building being devoted to rehabilitation (sec. 147(d));

(4) The special arbitrage expenditure rules for certain construction bond proceeds apply to construction proceeds of the bonds (sec. 148(f)(4)(C));

(5) The tenant targeting rules applicable to exempt-facility bonds for residential rental property (and the corresponding change in use penalties for violation of those rules) do not apply to such property financed with the bonds (secs. 142(d) and 150(b)(2));

(6) Rules similar to the rules of section 143(a)(2)(A)(iv), regarding the use of loan repayments, apply to bonds authorized under the provision;

(7) Interest on the bonds is not a preference item for purposes of the alternative minimum tax preference for private activity bond interest (sec. 57(a)(5)); and

(8) The pro rata interest deduction disallowance rule for financial institutions that invest in tax-exempt bonds is waived for such institutions purchasing the special tax-exempt bonds authorized in the proposal (sec. 265(b)(3)).

Coordination with emergency appropriations

The provision reduces the amount that otherwise would be available for disaster recovery activities and assistance related to the terrorist acts in New York City under the Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States (Public Law 107–38).

EFFECTIVE DATE

The provision is effective for bonds issued after the date of enactment.

C. Incentive for Reinvestment in New York City

(Sec. 303 of the bill)

PRESENT LAW

In recent years, provisions have been added to the Internal Revenue Code that target specific geographic areas for special Federal income tax treatment. In general, these areas suffer from pervasive poverty, high unemployment, and general distress, which result in a lack of business investment. The provisions in the Code are designed to stimulate greater business investment in these geographical areas by offering tax incentives to taxpayers that operate businesses in these areas. Examples of such provisions are the empowerment zone and renewal community provisions (secs. 1392–1397F, 1400E–1400J).

In the case of damage or destruction to property used in a trade or business, a taxpayer may deduct any loss sustained, to the extent the loss is not compensated by insurance or otherwise (sec. 165(a)).[19]

If a taxpayer realizes gain from the destruction or damage of property by reason of compensation by insurance or otherwise, the taxpayer may elect to limit the recognition of gain to the amount by which the amount realized exceeds the cost of replacement property which is purchased within a specified time period and which is similar or related in use to the property damaged or destroyed (sec. 1033(a)). The basis of the replacement property is decreased by the amount of gain not recognized.

Gain on the disposition of section 1245 property (depreciable property other than real estate) is treated as ordinary income to the extent of any depreciation deductions allowed. Gain on the disposition of section 1250 property (depreciable real estate) is treated as ordinary income to the extent the depreciation deductions exceed the amount of depreciation deductions allowable on the straight-line method of depreciation. Exceptions are provided for involuntary conversions of property under certain circumstances.

REASONS FOR CHANGE

The Committee believes that the present-law incentive under section 1033 that permits reinvestment of insurance proceeds for damaged or destroyed property is inadequate in light of the severity of the September 11, 2001 terrorist attacks. The Committee believes that further incentives are necessary to encourage taxpayers that suffered business property losses within the New York Recovery Zone to reinvest any insurance proceeds in New York City. Without further incentives, businesses that were located in the New York Recovery Zone may choose to relocate their business operations outside of New York City, thereby further hindering New York City's efforts to recover from the terrorist attacks.

EXPLANATION OF PROVISION

Under the provision, a taxpayer can elect to not take into account insurance proceeds in determining gain or loss (for regular tax and alternative minimum tax purposes) with respect to eligible property damaged or destroyed in the New York Recovery Zone as a result of the September 11, 2001 terrorist attacks. Insurance proceeds may be disregarded only to the extent the electing taxpayer purchases (from an unrelated party)[20] qualified replacement property no later than by December 31, 2006. In general, any increase in loss (or reduction in gain) resulting from this provision will be

[19] Section 165(i) allows taxpayers to deduct, in the preceding year, any uncompensated loss attributable to a disaster area determined by the President of the United States as warranting assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act.

[20] Section 1033(i) contains a similar prohibition regarding the acquisition of replacement property.

taken into account in the taxable year that includes September 11, 2001.

An election under this provision will be made at such time and in such manner as the Secretary of the Treasury may prescribe. The election is binding for that taxable year and all subsequent taxable years.

Eligible property means depreciable tangible personal property [21] and qualified leasehold improvement property,[22] substantially all of the use of which (as of September 11, 2001) was in a business establishment of the taxpayer located in the New York Recovery Zone.[23] Qualified replacement property means tangible personal property or qualified leasehold improvement property purchased by the taxpayer on or after September 11, 2001 and placed in service in New York City before January 1, 2007. In addition, the original use of such property in New York City must begin with the taxpayer, and substantially all of the property's use is reasonably expected to be in connection with the taxpayer's business establishment located in New York City.[24]

If the taxpayer is a member of an affiliated group of corporations filing a consolidated return, the provision permits the replacement property to be purchased by any member of the affiliated group (in lieu of the taxpayer). It is anticipated that the Secretary of the Treasury will issue guidance as may be necessary to ensure that gain shall not be recognized under the consolidated return provisions and to ensure that any investment adjustments, or any other adjustments under the consolidated regulations, accurately reflect the implications of permitting another member of the consolidated group to purchase the qualifying replacement property.

If a taxpayer makes an election under this provision, a number of special rules apply. First, an electing taxpayer is not permitted to elect under section 165(i) to treat such losses as occurring in the preceding taxable year. Second, sections 1245 and 1250 will not result in the recognition of any gain with respect to the eligible property that is eliminated by reason of the election.[25] Third, for purposes determining the amount of gain recognized under section 1033(a)(2)(A), the amount realized from the conversion of the eligible property does not include any insurance proceeds that are disregarded under this provision, and the cost of any qualified replacement property is not taken into account (see example 3, below).

The basis of qualified replacement property is reduced by the amount of the insurance proceeds not taken into account by reason of the election. The amount of the proceeds reinvested in qualified

[21] For this purpose, tangible personal property is defined by reference to section 1245(a)(3).

[22] For this purpose, the term "qualified leasehold improvement property" has the same meaning as in the proposal to provide a special depreciation allowance in Part II.A., above.

[23] The "New York Recovery Zone" is defined as the area located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan, New York, New York.

[24] It is expected that a rule similar to section 179(d)(10) will apply to recapture the benefits of this provision in circumstances so as to prevent the avoidance of the purpose of this provision (i.e., to encourage the purchase of business property with the insurance proceeds for use in New York City). Thus, for example, the benefits of this provision should be recaptured if a taxpayer converts the qualified replacement property into personal use property. On the other hand, the benefits should not be recaptured if the qualified replacement property is replaced by other qualified replacement property.

[25] Thus, for example, section 1245(b)(4)(B) will not apply where an electing taxpayer replaces tangible personal property with qualified leasehold improvement property.

replacement property is treated as depreciation for purposes of sections 1245 and 1250.[26] Therefore, all or a portion of any gain on a sale or other disposition of any qualified replacement property may be characterized as ordinary income.

If a taxpayer makes an election provided by the provision, the time for assessment of any deficiency attributable to the election shall not expire prior to the expiration of three years from the date the Secretary of the Treasury is notified by the taxpayer of the replacement of the converted property or of the intention not to replace (in a manner similar to the extension of the statute of limitations under section 1033(a)(2)).

The provision reduces the amount that would otherwise be available for disaster recovery activities and assistance related to the terrorist acts in New York City under the Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States (Public Law 107–38).

The following examples illustrate the operation of the provision.

> Example 1.—A calendar-year corporation owned eligible property with an adjusted basis of $1 million that it used in its trade or business and was destroyed in the New York Recovery Zone. The property was fully insured for its fair market value of $1.5 million and the corporation receives insurance proceeds of that amount. In 2006, the corporation purchases qualified replacement property in New York City at a cost of $1.7 million. If the corporation makes the election provided by the provision, the corporation is allowed a deduction for the $1 million cost of its converted property. The corporation's basis in the qualified replacement property is $200,000 ($1.7 million cost less the $1.5 million of disregarded insurance proceeds). On a disposition of the replacement property, the first $1.5 million of gain will be characterized as ordinary income under this provision.
>
> Example 2.—Same facts as in example 1 except that the cost of the qualified replacement property is $1.3 million. The corporation is allowed a deduction for $800,000 on its converted property ($1 million basis less $200,000 of non-reinvested insurance proceeds). The corporation's basis in qualified replacement property is zero ($1.3 million cost less the $1.3 million of disregarded insurance proceeds). On a disposition of the replacement property, the first $1.3 million of gain will be characterized as ordinary income under this provision.
>
> Example 3.—Same facts as in example 1 except that the cost of the qualified replacement property is $200,000. Also assume that the corporation uses $1.2 million of the insurance proceeds to purchase tangible property of a similar character to the converted property in a transaction that satisfies the requirements of section 1033. Under this provision, $200,000 of the insurance proceeds is disregarded. The corporation's basis in the qualified replacement property is zero ($200,000 cost less the $200,000 of disregarded insurance proceeds).[27] As to

[26] Section 1017(d)(2) contains a similar recapture rule in connection with basis reductions attributable to discharge of indebtedness income that is excluded under section 108.

[27] On a disposition of the replacement property, the first $200,000 of gain will be characterized as ordinary income under this provision.

the remaining $1.3 million of insurance proceeds, the corporation has $300,000 of realized gain ($1.3 million less $1.0 million basis in the converted property). However, the corporation will recognize only $100,000 of this gain by virtue of the application of section 1033(a)(2) ($1.3 million less $1.2 million used to purchase the tangible property under section 1033). The corporation's basis in the tangible property is $1 million ($1.2 million cost less $200,000 of gain not recognized under section 1033).

EFFECTIVE DATE

The provision is effective for involuntary conversions in the New York Recovery Zone occurring on or after September 11, 2001, as a consequence of the terrorist attacks on such date.

D. RE-ENACT EXCEPTIONS FOR QUALIFIED MORTGAGE BOND FINANCED LOANS TO VICTIMS OF PRESIDENTIALLY DECLARED DISASTERS

(Sec. 304 of the bill and Sec. 143(k)(11) of the Code)

PRESENT LAW

Tax-exempt private activity bonds may be issued to finance mortgage loans to certain first-time homebuyers (secs. 103, 141, and 143). The purchase price of housing financed with these loans is restricted, and the incomes of the homebuyers must be below prescribed levels. More liberal rules apply to loans to homebuyers in targeted areas of economic distress. For bonds issued during 1997 and 1998, loans made in Presidentially declared disaster areas during the two years following the disaster declaration were exempt from certain of these targeting rules.

In addition to loans to finance the purchase of homes, qualified mortgage bond proceeds may be used to finance certain "rehabilitation loans" and "home improvement loans." Rehabilitation loans are limited to houses that are at least 20 years old. The maximum principal amount of any home improvement loan is $15,000.

REASONS FOR CHANGE

The Committee believes it is appropriate to re-instate the more liberal qualified mortgage bond targeting rules for loans to repair or replace homes damaged or destroyed in a disaster.

EXPLANATION OF PROVISION

The prior-law exception for qualified-mortgage-bond-financed loans made during the two-year period following a Presidential disaster declaration is re-enacted for loans made to finance replacement or repair of housing damaged or destroyed in the disaster. Additionally, the size limit for home improvement loans is increased from $15,000 to $25,000 per borrower for houses damaged in a qualifying disaster.

EFFECTIVE DATE

The provision applies to bonds issued during calendar year 2002.

E. One-Year Expansion of Authority for Indian Tribes to Issue Tax-Exempt Private Activity Bonds

(Sec. 305 of the bill and Sec. 7871 of the Code)

PRESENT LAW

Rules governing issuance of tax-exempt bonds

In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (sec. 103). Interest on 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 a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called "private activity bonds."[28] The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

Issuance of tax-exempt private activity bonds for housing

Present law includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities. Among the activities eligible for financing are qualified residential rental projects. Generally, for qualified residential rental projects, 40 percent or more of the units in the project must be occupied by tenants having incomes of 60 percent or less of the area median gross income or 20 percent or more of the units must be occupied by tenants having incomes of 50 percent or less of the area median gross income. Residential rental housing projects generally must satisfy this low-income tenant set-aside for a minimum period of 15 years.

Tax-exempt private activity bonds also may be issued to finance certain mortgage loans for owner-occupied housing ("qualified mortgage bonds"). Purchasers of houses financed with qualified mortgage bonds must be first-time homebuyers satisfying prescribed income limits, the purchase prices of the houses is limited, the amount by which interest rates charged to homebuyers may exceed the interest paid by issuers is restricted, and a recapture provision applies to target the benefit to purchasers having longer-term need for the subsidy provided by the bonds.

In most cases, the aggregate volume of tax-exempt private activity bonds (including rental housing bonds and qualified mortgage bonds) that may be issued in a State is restricted by annual volume limits. These annual volume limits are equal to $62.50 per resident of the State, or $187.5 million if greater. The volume limits are scheduled to increase to the greater of $75 per resident of the State or $225 million in calendar year 2002. After 2002, the volume limits will be indexed annually for inflation.

[28] Interest on private activity bonds (other than qualified 501(c)(3) bonds) is a preference item in calculating the alternative minimum tax.

Enterprise zone facility bonds

Qualified businesses operating in enterprise communities and empowerment zones are eligible to finance property with tax-exempt private activity bonds ("enterprise zone facility bonds"). Generally, to be entitled to tax-exempt treatment, 95 percent of the proceeds of qualified enterprise zone bonds must be used to finance qualified zone property, the principal user of which is a qualified enterprise zone business.

These bonds are exempt from the general State private activity bond volume limits but are subject to the applicable per zone limitations. For bonds issued after December 31, 2001 (other than the D.C. Enterprise Zone), the following aggregate limitations on the face amount of the bonds apply: (1) 60 million if the zone is located in a rural area; (2) $130 million if the bonds are located in an urban area with a population under 100,000; or (3) $230 million if the zone is an urban area with a population of at least 100,0000.[29]

Special rules for Indian tribes

Under present law, Indian tribal governments may issue tax-exempt bonds in two general circumstances. First, tribal governments are treated as States and may issue governmental bonds to finance "essential governmental functions." An essential governmental function is defined as an activity that is customarily performed by States. Second, tribal governments may issue private activity bonds to finance the acquisition, construction, reconstruction or improvement of property that is part of a manufacturing facility. The bond-financed property must be located on qualified Indian land and must be owned and operated by an Indian tribal government. Issuance of these manufacturing-facility bonds is subject to an annual tribal employment test in lieu of annual dollar volume limits.

Tax credit for certain low-income housing projects

Present law provides an income tax credit for rental housing units that are occupied by low-income tenants (sec. 42). The credit is claimed over a 10-year period and has a present-value of 70 percent (new construction not receiving other Federal subsidies generally) or 30 percent (existing housing and new construction receiving other Federal subsidies) of total qualified expenditures. The term Federal subsidy includes tax-exempt financing.

In general, project owners receive low-income housing credits only if the State where the property is located allocates credits to them. States receive annual credit authority of $1.50 per resident (calendar year 2001). This authority is scheduled to increase to $1.75 in calendar year 2002; the $1.75 amount will be adjusted for inflation annually after 2002. No allocation of State credit authority is required for low-income housing projects that are financed with the proceeds of tax-exempt bonds if the bonds are issued subject to the State private activity bond volume limits.

[29] For pre-December 31, 2001 enterprise zone bonds, the per-business size limitations for Round I empowerment zones and enterprise communities (i.e., $3 million for each qualified enterprise zone business with a maximum of $20 million for each principal user for all zones and communities) apply. The per-business size limitations do not apply to qualifying bonds issued for Round II empowerment zones.

REASONS FOR CHANGE

The Committee believes by expanding the authority of qualified Indian tribes to issue private activity bonds, the tribes will experience increased economic activity and improved housing for Members of such tribes.

EXPLANATION OF PROVISION

During calendar year 2002, each qualified Indian tribal government is permitted to issue up to $10 million of tax-exempt private activity bonds to finance three activities, in addition to the activities for which such entity may issue such bonds under present law. Bond authority that is not issued in 2002 may be carried forward for up to three years under rules similar to the rules governing carryforward of authority under the general State private activity bond volume limits. Interest on these bonds is not a preference item for purposes of the alternative minimum tax.

First, Indian tribal governments may issue bonds for residential rental projects, defined as under the general tax-exempt private activity bond rules except the determination of tenant income is made by reference to statewide median gross income. For purposes of the low-income housing tax credit, bonds issued subject to the $10 million limit are treated as if they were issued under the general Code private activity bond volume limits; thus, the low-income housing credit is available for these residential rental housing projects without the necessity of an allocation of State housing credit authority.

Second, Indian tribal governments may allocate authority under the $10 million limit to issuance of qualified mortgage bonds. Issuance of such qualified mortgage bonds is subject to the restrictions of Code section 143.

Finally, Indian tribal governments may allocate authority under the $10 million limit to financing for businesses that would qualify as enterprise zone businesses if the Indian reservation over which the qualified Indian tribe exercises general governmental authority were treated as an empowerment zone. Businesses owned by a tribal government are not precluded from qualifying for these bonds if all requirements were otherwise met. Businesses a principal purpose of which is the retail sale of tobacco products or highway motor fuels are not eligible for financing with these bonds unless the tribal government has entered into an agreement with the State where the facility is to be located to collect applicable State taxes on these products.

Qualified tribal governments (i.e., tribal governments receiving authority to issue bonds under the proposal) are required to have a joblessness rate of at least 25 percent among the Members of the tribe. This determination is based on the *Indian Labor Force Report*, published by the Bureau of Indian Affairs, for the most recent calendar year preceding the issuance of the bonds.

Treasury report

The Treasury Department is directed to compile necessary data from the information reports required under present law when tax-exempt bonds are issued and to report on (1) which Indian tribes used the authority and (2) the activities for which the bonds were issued. The Treasury Department is directed to report this information to the House Committee on Ways and Means and the Senate Committee on Finance no later than September 30 of the calendar year following the year in which the bond issuance occurs.

EFFECTIVE DATE

The provision is effective for bonds issued after the date of enactment.

IV. VICTIMS RELIEF PROVISIONS

A. Background and Reasons for Change

PRIOR LEGISLATION

Historically, the Congress has provided Federal tax relief for members of the U.S. Armed Forces who serve in combat zones. In addition, the Congress has taken action on several occasions to provide Federal tax relief for service members and other individuals whose lives have been affected by particular instances of hostile action involving the United States. In 1970, the Congress enacted legislation that provided tax relief to individuals who had been removed from a U.S. vessel and died while being illegally detained by the Democratic People's Republic of Korea during 1968.[30] Specifically, the legislation treated these individuals as having served in a combat zone for purposes of tax provisions that apply only to individuals serving in designated combat zones. Thus, service personnel who were crewmembers of the U.S.S. *Pueblo* (which was illegally detained in 1968 by North Korea), and who died during the detention, were eligible for the income tax exclusion (and other special tax rules) available for service personnel who die in combat zones.

In 1980, the Congress enacted legislation concerning the American hostages who were held captive in Iran between November 4, 1979, and December 31, 1981, and who died as a result of injury or disease or physical or mental disability that was incurred or aggravated while in captive status.[31] The legislation provided that no Federal income tax would be imposed with respect to the year in which the individual died or any prior year ending on or after the first day the individual was in captive status. This legislation applied to military and civilian personnel of the United States, as well as to certain other U.S. taxpayers taken captive outside Iran on or before December 31, 1981. Moreover, if there had been any unpaid income tax liability of such an individual from years prior to captivity, the liability was forgiven. This total income tax exemption for American hostages who died as a result of captive status was available only if death occurred within two years after the individual ceased to be in captive status.

In 1984, the Congress enacted legislation after hostile action occurred in Lebanon and Grenada involving U.S. military and civilian personnel.[32] This legislation provided special Federal income

[30] Pub. L. No. 91–235.
[31] Pub. L. No. 96–449.
[32] Pub. L. Nos. 98–259 and 98–369.

tax rules for certain individuals who die while in active service as a member of the Armed Forces of the United States or while in the civilian employment of the United States. Under the legislation, if death occurs as a result of wounds or injuries incurred outside the United States in a terrorist or military action, then no Federal income tax applies with respect to income of the individual for the year of death or for any earlier year in the period beginning with the last year ending before the year in which the wounds or injuries were incurred (sec. 692(c)). The legislation only applies to injuries or wounds that are incurred in a terrorist or military action. Thus, for example, the legislation would not have applied with respect to a U.S. serviceperson stationed in Lebanon who died as a result of an accidental fall because, if not caused by hostile forces, such an injury was not incurred in a terrorist or military action. In order to apply the special tax rules provided by the legislation to other hostile actions that occurred before the date of enactment (such as the attempt to rescue the American hostages in Iran), the legislation was made effective with respect to all taxable years of individuals dying as a result of wounds or injuries incurred after December 31, 1979.

The 1984 legislation applies to the year preceding the year in which the wounds or injuries were incurred because the Congress determined that forgiveness of income tax only for the period from the year of the injuries or wounds to the year of death would have inequitable results in certain circumstances. Under such a limitation, a soldier who is killed in a terrorist attack on a U.S. base in a foreign country on January 31 would be exempt from income tax only on one month's income, while a soldier who is killed in an attack on December 31 would be exempt from income tax on an entire year's income. Accordingly, the Congress concluded that it is more equitable to extend the tax forgiveness under the provision to income for the year preceding the year of injury.

In 1990, the Congress enacted legislation providing limited income tax benefits to victims of the terrorist attack that resulted in the downing of Pan American Airways Flight 103 over Lockerbie, Scotland on December 21, 1988.[33] The legislation provided that, in the case of any individual whose death was a direct result of the terrorist attack involving Flight 103, the income tax provisions of subtitle A of the Internal Revenue Code did not apply with respect to: (1) the taxable year that included December 21, 1988; and (2) the prior taxable year. However, the income tax benefit in each taxable year was limited to an amount equal to 28 percent of the annual rate of basic pay at Level V of the U.S. Executive Schedule as of December 21, 1988. This limitation was intended to limit the amount of tax relief to that which was provided to personnel of the United States who were on Flight 103, thus providing equal relief to all of the victims who were on Flight 103. In addition, the legislation required the President to submit recommendations to Congress concerning whether future legislation should be enacted to authorize the United States to provide monetary and tax relief as compensation to U.S. citizens who are victims of terrorism. The legislation also authorized the President to establish a board to de-

[33] Pub. L. No. 101–604.

velop criteria for compensation and to recommend changes to existing laws to establish a single comprehensive approach to victim compensation for terrorist acts.

In 1991, the Congress enacted legislation extending the benefits of the suspension of time provisions under section 7508 to any individual (and the spouse of such an individual) who performed certain services that preceded the designation of a combat zone with regard to Operation Desert Shield.[34] The individuals eligible for such benefits included individuals who provided services in the Armed Forces of the United States (or in support of the Armed Services) if such services were performed in the area designated by the President as the "Persian Gulf Desert Shield Area" and such services were performed during the period beginning August 2, 1990, and ending on the date on which any portion of the area was designated by the President as a combat zone. After January 17, 1991 (the date on which the Persian Gulf Desert Shield Area became designated as a combat zone by the President), individuals performing such services became eligible for the benefits of the present-law tax provisions applicable to service in a designated combat zone. An Executive Order terminating the designation of the Persian Gulf Desert Shield Area as a combat zone has not been issued.

In 1996, the Congress enacted legislation concerning certain individuals serving in portions of former Yugoslavia (i.e., Bosnia and Herzegovina, Croatia, and Macedonia) as part of Operation Joint Endeavor and Operation Able Sentry.[35] This legislation provided that such service is treated in the same manner as if it were performed in a designated combat zone for purposes of the tax provisions applicable to service in a designated combat zone. The legislation also made the suspension of time provisions of section 7508 applicable to certain other individuals participating in Operation Joint Endeavor. In addition, the legislation increased the maximum officer combat pay exclusion from $500 per month to the highest rate of pay applicable to enlisted personnel plus the amount of hostile fire/imminent danger pay received by the officer.

In 1997, the Congress enacted legislation authorizing procedural tax benefits with regard to Presidentially declared disasters in general.[36] The legislation provided that the Secretary of the Treasury may prescribe regulations under which a period of up to 90 days may be disregarded for performing various acts under the Internal Revenue Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, for any taxpayer determined by the Secretary to be affected by a Presidentially declared disaster (sec. 7508A). In 2001, the Congress amended section 7508A to extend from 90 to 120 the authorized period of days that may be disregarded by the Secretary.

[34] Pub. L. No. 102–2.
[35] Pub. L. No. 104–117.
[36] Pub. L. No. 105–34.

REASONS FOR CHANGE

Relief for victims of April 19, 1995, and September 11, 2001, terrorist attacks

The Committee believes that it is appropriate to provide tax relief to the victims of the terrorist attacks against the United States on September 11, 2001, and April 19, 1995 (the bombing of the Alfred P. Murrah Federal Building in Oklahoma City).

Under present law, tax relief from income and employment taxes is afforded to members of the Armed Forces on death. Present law also provides a reduction in Federal estate tax for members of the U.S Armed Forces who are killed in action while serving in a combat zone. The Committee believes that similar tax benefits should be afforded to victims of the September 11, 2001, and April 19, 1995, terrorist attacks.

For the victims of the September 11, 2001, terrorist attacks, the Committee also finds it appropriate to provide an exclusion from gross income for amounts that would otherwise be includible in gross income by reason of indebtedness of a taxpayer that is discharged as a result of the taxpayer's death in the terrorist attack. In light of the numerous charitable organizations making payments as a result of the September 11, 2001, terrorist attacks, the Committee believes it appropriate to provide that qualified payments made by charitable organizations are exempt payments.

General relief for victims of disaster and terroristic or military actions

In addition to the specific tax relief provided to the victims of the terrorist acts of September 11, 2001, and April 19, 1995, the Committee finds it appropriate to provide general relief for victims of disaster and terrorist or military actions. The Committee finds it necessary to clarify and expand present law.

The Committee believes it necessary to clarify that disaster relief payments are excludable from income. Because many forms of disasters make it difficult for taxpayers to meet required tax deadlines, the Committee believes it appropriate to grant authority to the Internal Revenue Service to postpone certain deadlines. Additionally, the Committee finds it beneficial to establish an Internal Revenue Service disaster response team to assist taxpayers in resolving Federal tax matters associated with or resulting from a disaster. To provide additional relief and clarification to victims of terrorist activity, the Committee also believes it appropriate to clarify and expand current law regarding death and disability payments made in connection with terrorist or military action.

For purposes of investigating terrorist activity or threats and analyzing intelligence, the Committee believes it is necessary to expand present law disclosure rules.

The Committee also finds it necessary to clarify that the special deposit rules under the Air Transportation Safety and System Stabilization Act[37] do not apply to employment taxes.

[37] Pub. L. No. 107–42.

B. Relief Provisions for Victims of the Terrorist Attacks on September 11, 2001, and April 19, 1995

1. Income and employment taxes of victims of terrorist attacks (Sec. 311 of the bill and Sec. 692 of the Code)

PRESENT LAW

An individual in active service as a member of the Armed Forces who dies while serving in a combat zone (or as a result of wounds, disease, or injury received while serving in a combat zone) is not subject to income tax or self-employment tax for the year of death (as well as for any prior taxable year ending on or after the first day the individual served in the combat zone) (sec. 692(a)(1)). Special computational rules apply in the case of joint returns. Military and civilian employees of the United States are entitled to this exemption if they die as a result of wounds or injury which was incurred outside the United States in terrorist or military action (sec. 692(c)).

The exemption applies not only to the tax liability of the individual attributable to income received before the date of death and reported on the decedent's final return. The exemption applies also to the liability of another person to the extent the liability is attributable to an amount received after the individual's death which would have been includible in the individual's income for the taxable year in which the date of death falls (determined as if the individual had survived).[38] For example, the individual's final wage payment, or interest or dividends payable in the year of death with respect to the individual's assets, are exempt from income tax when paid to another person or the individual's estate after the date of death but before the end of the taxable year of the decedent (determined without regard to the death).

This exemption is available for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury were incurred. Thus, for example, if someone is injured and dies in the year the injury occurred, the exemption applies for the year of death and the prior taxable year. Similarly, if someone is injured and dies two years later, this exemption is available for the taxable year of death as well as the three prior taxable years (i.e., the year preceding the injury, the year of the injury, and the two years following the year of the injury).

EXPLANATION OF PROVISION

Application of relief to victims of September 11, 2001, and April 19, 1995, attacks

The bill generally treats individuals who die as a result of wounds or injury which were incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, in the same manner as military or civilian employees of the United States dying as a result of terrorist or military activity outside the United States for purposes of section 692(c) of the Internal Revenue Code. Thus, such individuals generally are exempt from in-

[38] Treas. Reg. sec. 1.692–1(a)(2)(ii).

come and self-employment tax for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury occurred. The exemption applies to these individuals whether killed in an attack (e.g., in the case of the September 11, 2001, attack in one of the four airplanes or on the ground) or in rescue or recovery operations.

Subject to rules prescribed by the Secretary, the exemption from tax does not apply to the tax attributable to (1) amounts payable in the taxable year by reason of the death if the amount would have been payable in such year if the death had occurred by reason of an event other than the attacks of September 11, 2001, or April 19, 1995, or (2) amounts payable in the taxable year which would not have been payable in such taxable year but for an action taken after September 11, 2001, or April 19, 1995 (as applicable). Thus, for example, the exemption does not apply to amounts payable from a qualified plan or individual retirement arrangement to the beneficiary or estate of the individual. Similarly, amounts payable only as death or survivor's benefits pursuant to preexisting arrangements that would have been paid if the death had occurred for another reason are not covered by the exemption. In addition, if the individual's employer makes adjustments to a plan or arrangement to accelerate the vesting of restricted property or the payment of nonqualified deferred compensation after September 11, 2001, or April 19, 1995, the exemption does not apply to income received as a result of that action.[39] Also, if the individual's beneficiary cashed in savings bonds of the decedent, the exemption does not apply. On the other hand, the exemption does apply, for example, to a final paycheck of the individual or dividends on stock held by the individual when paid to another person or the individual's estate after the date of death but before the end of the taxable year of the decedent (determined without regard to the death).

The provision does not apply to any individual identified by the Attorney General to have been a participant or conspirator in the terrorist attacks, or a representative of such individual.

Application of relief to payroll taxes

The bill provides for a refund of the amount of both the employer and employee portion of FICA and Tier I Railroad Retirement taxes whenever the taxpayer is eligible for an exemption from income taxes under section 692. Because the refund is measured by the amount of these taxes, but is not a refund of such taxes, the refunds will be made from the general fund of the Treasury, not from the trust funds associated with these taxes. Similarly, benefits will not be reduced because of the refund of the amount of these payroll taxes.

Simplified refund procedures

It is intended that the Secretary will establish procedures to simplify refunds of these amounts, including expanding the directions in Revenue Procedure 85–35 to include specific instructions for Form 1041.

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[39] Such amounts may, however, be excludable from gross income under the death benefit exclusion provided in section 204 of the bill.

EFFECTIVE DATE

The provision is effective for taxable years ending before, on, or after September 11, 2001.

A special rule extends the period of limitations to permit the filing of a claim for refund resulting from this provision until one year after the date of enactment, where that period would otherwise have expired before that date.

2. Estate tax reduction (Sec. 312 of the bill and Sec. 2201 of the Code)

PRESENT LAW

Present law provides a reduction in Federal estate tax for taxable estates of U.S. citizens or residents who are active members of the U.S. Armed Forces and who are killed in action while serving in a combat zone (sec. 2201). This provision also applies to active service members who die as a result of wounds, disease, or injury suffered while serving in a combat zone by reason of a hazard to which the service member was subjected as an incident of such service.

In general, the effect of section 2201 is to replace the Federal estate tax that would otherwise be imposed with a Federal estate tax equal to 125 percent of the maximum State death tax credit determined under section 2011(b). Credits against the tax, including the unified credit of section 2010 and the State death tax credit of section 2011, then apply to reduce (or eliminate) the amount of the estate tax payable.

The reduction in Federal estate taxes under section 2201 is equal in amount to the "additional estate tax" with respect to the estates of decedents dying before January 1, 2005. The additional estate tax is the difference between the Federal estate tax imposed by section 2001 and 125 percent of the maximum State death tax credit determined under section 2011(b). With respect to the estates of decedents dying after December 31, 2004, section 2201 provides that the additional estate tax is the difference between the Federal estate tax imposed by section 2001 and 125 percent of the maximum state death tax credit determined under section 2011(b) as in effect prior to its repeal by the Economic Growth and Tax Relief Reconciliation Act of 2001.

EXPLANATION OF PROVISION

The bill generally treats individuals who die from wounds or injury incurred as a result of the September 11, 2001, or April, 19, 1995, terrorist attacks in the same manner as if they were active members of the U.S. Armed Forces killed in action while serving in a combat zone or dying as a result of wounds or injury suffered while serving in a combat zone for purposes of section 2201. Consequently, the estates of these individuals are eligible for the reduction in Federal estate tax provided by section 2201. The provision applies regardless of whether the individual was killed in the attack itself (e.g., in the case of the September 11, 2001, attack, in one of the four airplanes or on the ground) or in rescue or recovery operations.

The bill also changes the general operation of section 2201, as it applies to both the estates of service members who would qualify for special estate tax treatment under present law and the estates of victims of the September 11, 2001, or April 19, 1995, terrorist attacks. Under the bill, the Federal estate tax is determined in the same manner for all estates that are eligible for Federal estate tax reduction under section 2201. In addition, the executor of an estate that is eligible for special estate tax treatment under section 2201 may elect not to have section 2201 apply to the estate. Thus, in the event that an estate may receive more favorable treatment without the application of section 2201 in the year of death than it would under section 2201, the executor may elect not to apply the provisions of section 2201, and the estate tax owed (if any) would be determined pursuant to the generally applicable rules.

Under the bill, section 2201 no longer reduces Federal estate tax by the amount of the additional estate tax. Instead, the bill provides that the Federal estate tax liability of eligible estates is determined under section 2001, using a rate schedule that is equal to 125 percent of the present-law maximum State death tax credit amount. This rate schedule is used to compute the tax under section 2001(b) (i.e., both the tentative tax under section 2001(b)(1) and the hypothetical gift tax under section 2001(b)(2) is computed using this rate schedule). As a result of this provision, the estate tax is unified with the gift tax for purposes of section 2201 so that a single graduated (but reduced) rate schedule applies to transfers made by the individual at death, based upon the cumulative taxable transfers made both during lifetime and at death.

In addition, while the bill provides an alternative reduced rate table for purposes of determining the tax under section 2001(b), the amount of the unified credit nevertheless is determined as if section 2201 did not apply, based upon the unified credit as in effect on the date of death. For example, in the case of victims of the September 11, 2001, terrorist attack, the applicable unified credit amount under section 2010(c) would be determined by reference to the actual section 2001(c) rate table.

As a conforming amendment, the bill repeals section 2011(d) because it no longer will have any application to taxpayers.

Participants or conspirators in the September 11, 2001, or April 19, 1995, terrorist attacks (including representatives of such individuals) are not eligible for the benefits of the provision. The determination as to whether an individual is a participant or conspirator is made by the Attorney General.

EFFECTIVE DATE

The provision applies to estates of decedents dying on or after September 11, 2001, or, in the case of victims of the Oklahoma City terrorist attack, estates of decedents dying on or after April 19, 1995.

A special rule extends the period of limitations to permit the filing of a claim for refund resulting from this provision until one year after the date of enactment, where that period would otherwise have expired before that date.

3. Payments by charitable organizations treated as exempt payments (Sec. 313 of the bill and Secs. 501 and 4941 of the Code)

PRESENT LAW

In general, organizations described in section 501(c)(3) of the Code are exempt from taxation. Contributions to such organizations generally are tax deductible (sec. 170). Section 501(c)(3) organizations must be organized and operated exclusively for exempt purposes and no part of the net earnings of such organizations may inure to the benefit of any private shareholder or individual. An organization is not organized or operated exclusively for one or more exempt purposes unless the organization serves a public rather than a private interest. Thus, an organization described in section 501(c)(3) generally must serve a charitable class of persons that is indefinite or of sufficient size.

Tax-exempt private foundations are a type of organization described in section 501(c)(3) and are subject to special rules. Private foundations are subject to excise taxes on acts of self-dealing between the private foundation and a disqualified person with respect to the foundation (sec. 4941). For example, it is self-dealing if the income or assets of a private foundation are transferred to, or used by or for the benefit of a disqualified person, such as a substantial contributor to the foundation or a person in control of the foundation, and the benefit is not incidental or tenuous.

EXPLANATION OF PROVISION

In light of the extraordinary distress caused by the attacks on the United States of September 11, 2001, the bill provides that organizations described in section 501(c)(3) that make payments by reason of the death, injury, or wounding of an individual incurred as a result of the September 11, 2001 attacks are not required to make a specific assessment of need for the payments to be related to the purpose or function constituting the basis for the organization's exemption, provided that the organization uses an objective formula which is consistently applied, in making the payments. As under present law, such payments must be for public and not private benefit and therefore must serve a charitable class. For example, under this standard, a charitable organization that assists families of firefighters killed in the line of duty could make a prorata distribution to the families of firefighters killed in the attacks, even though the specific financial needs of each family are not directly considered. Similarly, if the amount of a distribution is based on the number of dependents of a charitable class of persons killed in the attacks and this standard is applied consistently among distributions, the specific needs of each recipient do not have to be taken into account. The bill also provides that if a private foundation makes such payments to a charitable class of persons on account of death, injury, or wounding in the attacks, the payment is not treated as made to a disqualified person for purposes of section 4941.

EFFECTIVE DATE

The provision applies to payments made on or after September 11, 2001.

4. Exclusion for certain cancellations of indebtedness (Sec. 314 of the bill)

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 farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108). In cases involving discharges of indebtedness that are excluded from gross income (except for discharges of real property business indebtedness), taxpayers generally exclude discharge of indebtedness from income but reduce tax attributes 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. 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).

Present law generally requires "applicable entities" to file information returns with the Internal Revenue Service regarding any discharge of indebtedness in the amount of $600 or more (sec. 6050P). This requirement applies without regard to whether the debtor is subject to tax on the discharged indebtedness (Treas. Reg. sec. 1.6050P–1(a)(3)). The term "applicable entities" includes: (1) any financial institution (as described in section 581 (relating to banks) or section 591(a) (relating to savings institutions)); (2) any credit union; (3) any corporation that is a direct or indirect subsidiary of an entity described in (1) or (2) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities; (4) the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the National Credit Union Administration, certain other Federal executive agencies, and any successor or subunit of any of them; (5) an executive, judicial, or legislative agency (as defined in 31 U.S.C. Sec. 3701(a)(4)); and (6) any other organization a significant trade or business of which is the lending of money. Failures to file correct information returns with the Internal Revenue Service or to furnish statements to taxpayers with respect to these discharges of indebtedness are subject to the same general penalty that is imposed with respect to failures to provide other types of information returns. Accordingly, the penalty for failure to furnish statements to taxpayers generally is $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

EXPLANATION OF PROVISION

The bill provides that gross income does not include any amount realized from the discharge (in whole or in part) of indebtedness of any individual who dies from wounds or injury incurred as a result of the September 11, 2001, terrorist attack if the discharge of indebtedness is by reason of the taxpayer having died as a result of the attack. Thus, gross income of a taxpayer does not include a discharge of indebtedness if the taxpayer was an obligor or co-obligor with respect to discharged indebtedness of an individual who died as a result of the September 11, 2001, terrorist attack (e.g., the spouse or estate of the individual), and the indebtedness was discharged because the individual died as a result of the attack.

The bill also provides that the information return filing requirements that otherwise apply to discharges of indebtedness do not apply with respect to any discharge of indebtedness that is excluded from gross income under this provision.

EFFECTIVE DATE

This provision applies to discharges made on or after September 11, 2001, and before January 1, 2002.

C. GENERAL RELIEF FOR VICTIMS OF DISASTERS AND TERRORISTIC OR MILITARY ACTIONS

1. Exclusion of disaster relief payments (Sec. 321 of the bill and new Sec. 139 of the Code)

PRESENT LAW

Taxation of disaster relief payments

Gross income includes all income from whatever source derived unless a specific exception applies (sec. 61). There is no specific statutory exclusion from income for disaster payments. However, various types of disaster payments made to individuals have been excluded from gross income under a general welfare exception.[40] The exception has been held to exclude from income payments made under legislatively provided social benefit programs for the promotion of the general welfare. The general welfare exception generally applies if the payments (1) are made from a governmental general welfare fund, (2) are for the promotion of the general welfare (on the basis of need and not to all residents), and (3) are made without respect to services rendered by the recipient. The exclusion generally applies to payments for food, medical, housing, personal property, transportation, and funeral expenses.

The general welfare exception generally does not apply to payments in the nature of income replacement, such as payments to businesses or payments to individuals for lost wages or unemployment compensation.[41] Income replacement payments are includable in gross income, unless another exception applies.

Disaster relief payments may be excludable under other provisions. For example, payments made by charitable relief organiza-

[40] Rev. Rul. 98–19, 1998–1 C.B. 840; Rev. Rul. 76–144, 1976–1 C.B. 17.

[41] IRS Publication 547 (Casualties, Disasters, and Thefts), page 5 (revised December 2000); Rev. Rul. 91–55, 1991–2 C.B. 321; Rev. Rul. 73–408, 1973–2 C.B. 15.

tions may be excluded from the gross income of the recipients as gifts. Payments made in a business context generally are not treated as gifts. Factual issues may arise as to whether a payment in the context of a business relationship is a gift or taxable compensation for services. In general, payments made by an employer to, or for the benefit of, an employee are not excluded from gross income as gifts (sec. 102(c)).

Under present law, gross income generally does not include payments received as damages (other than punitive damages) on account of personal physical injury (including death) or sickness (sec. 104(a)(2)). Such payments are excluded from gross income regardless of whether received by suit or agreement and whether received as a lump sum or as periodic payments.

Section 406 of the Air Transportation Safety and System Stabilization Act provides for the payment of compensation for eligible individuals who suffered physical harm or death as a result of the terrorist-related aircraft crashes of September 11, 2001. There is no statutory provision specifically addressing the taxation of such compensation; however, such compensation may be excludable from income under generally applicable Code provisions (e.g., section 104).

Rules relating to charitable organizations

In general, organizations described in section 501(c)(3) of the Code are exempt from taxation. Contributions to such organizations generally are tax deductible (sec. 170). Section 501(c)(3) organizations must be organized and operated exclusively for exempt purposes and no part of the net earnings of such organizations may inure to the benefit of any private shareholder or individual. An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, an organization described in section 501(c)(3) generally must serve a charitable class of persons that is indefinite or of sufficient size.

Tax-exempt private foundations are a type of organization described in section 501(c)(3) and are subject to special rules. Private foundations are subject to excise taxes on acts of self-dealing between the private foundation and a disqualified person with respect to the foundation (sec. 4941). For example, it is self-dealing if the income or assets of a private foundation are transferred to, or used by or for the benefit of a disqualified person, such as a substantial contributor to the foundation or a person in control of the foundation, and the benefit is not incidental or tenuous. Private foundations also are subject to excise taxes on taxable expenditures (sec. 4945). For example, it is a taxable expenditure if a private foundation pays an amount that does not further certain charitable purposes, or makes a grant to an individual for educational or other similar purposes without following certain procedures.

EXPLANATION OF PROVISION

Taxation of disaster relief payments

The bill clarifies that any amount received as payment under section 406 of the Air Transportation Safety and System Stabilization Act is excludable from gross income. In addition, the bill provides a specific exclusion from income for qualified disaster relief payments. No inference is intended as to the taxability of such payments under present law. In addition, the provision is not intended to preclude the exclusion of other types of payments under the general welfare exception or other Code provisions.

Qualified disaster relief payments include payments, from any source, to, or for the benefit of, an individual to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster. Personal, family, and living expenses are intended to have the same meaning as when used in section 262.

Qualified disaster relief payments also include payments, from any source, to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence, or for the repair or replacement of its contents, to the extent that the need for the repair, rehabilitation, or replacement is attributable to a qualified disaster. For purposes of determining the tax basis of a rehabilitated residence, it is intended that qualified disaster relief payments be treated in the same manner as amounts received on an involuntary conversion of a principal residence under section 121(d)(5) and sections 1033(b) and (h). A residence is not precluded from being a personal residence solely because the taxpayer does not own the residence; a rented residence can qualify as a personal residence.

Qualified disaster relief payments also include payments by a person engaged in the furnishing or sale of transportation as a common carrier on account of death or personal physical injuries incurred as a result of a qualified disaster. Thus, for example, payments made by commercial airlines to families of passengers killed as a result of a qualified disaster would be excluded from gross income.[42]

Qualified disaster relief payments also include amounts paid by a Federal, State or local government in connection with a qualified disaster in order to promote the general welfare. As under present law, the exclusion does not apply to payments made to businesses or payments in the nature of income replacement or unemployment compensation.

Qualified disaster relief payments do not include payments for any expenses compensated for by insurance or otherwise. No change from present law is intended as to the deductibility of qualified disaster relief payments, made by an employer or otherwise, merely because the payments are excludable by the recipients. In addition, in light of the extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify for the exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred.

Particular payments may come within more than one category of qualified disaster relief payments; the categories are not intended to be mutually exclusive. Qualified disaster relief payments also are excludable for purposes of self-employment taxes and employ-

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[42] The exclusion from income applies irrespective of section 104(a)(2). As previously discussed, no inference is intended that payments excludable under section 139 would not be otherwise excludable under another Code provision.

ment taxes. Thus, no withholding applies to qualified disaster relief payments.

Under the bill, a qualified disaster includes a disaster which results from a terroristic or military action (as defined in section 692(c)(2), as amended by the bill), a Presidentially declared disaster, a disaster which results from an accident involving a common carrier or from any other event which would be determined by the Secretary to be of a catastrophic nature, or, for purposes of payments made by a Federal, State or local government, a disaster designated by Federal, State or local authorities to warrant assistance.

The exclusion from income under section 139 does not apply to any individual identified by the Attorney General to have been a participant or conspirator in the terrorist-related aircraft crashes of September 11, 2001, or any other terrorist attack, or to a representative of such individual.

Rules applicable to charitable organizations making disaster relief payments

Recognizing that employers and employees may also contribute to section 501(c)(3) organizations that will make disaster relief payments, the Committee believes that clarification of the type of disaster relief grants such organizations may make consistent with exempt purposes to assist individuals in distress as a result of the September 11 attacks, and more generally, may be helpful. Because the bill provides a special rule for payments made by reason of death, injury, or wounding of an individual as a result of the September 11 attacks, the following discussion relates to disaster relief generally.

Generally speaking, a charitable organization must serve a public rather than a private interest. Providing assistance to relieve distress for individuals suffering the effects of a disaster generally serves a public rather than a private interest where the assistance benefits the community as a whole, or where the recipients otherwise lack the resources to meet their physical, mental and emotional needs. Such assistance could include cash grants to provide for food, clothing, housing, medical care, funeral costs, transportation, education and other needs. Except as specifically provided in the bill with respect to certain payments made in response to the September 11, 2001, attacks, all such grants must be need-based, taking into account the family's financial resources and their physical, mental and emotional well-being.

In light of the severity of distress arising out of the attacks on the United States on September 11, 2001, and the extensive variety of needs that the thousands of victims and their family members may have, the Committee expects that grants for a wide array of expenses will be consistent with operation for exclusively charitable purposes. For instance, payments to permit a surviving spouse with young children to remain at home with the children rather than being forced to enter the workplace seem to be appropriate to maintain the psychological well-being of the entire family. Similarly, assistance with elementary and secondary school tuition to permit a child to remain in the same educational environment seems to be appropriate, as does assistance needed for higher education. Assistance with rent or mortgage payments for the family's principal residence or car loans also seems to be appropriate to forestall losses of a home or transportation that would cause additional trauma to families already suffering. Other types of assistance that the scope of the tragedy makes it difficult to anticipate may also serve a charitable purpose.

Charitable organizations generally are in the best position to determine the type and amount of, and appropriate beneficiaries for, disaster relief. Accordingly, the Committee expects that the Secretary will presume that a charity providing cash assistance in good faith to victims (and their family members) of a qualified disaster is acting consistent with the requirements of section 501(c)(3) if the class of beneficiaries is sufficiently large or indefinite and the charity can demonstrate that it is applying consistent, objective criteria for assessing need.

In addition to the rules described above that are applicable to all charities, special rules apply with respect to disaster relief provided by private foundations controlled by an employer. In such cases, the Committee believes that clarification of the appropriate treatment of the foundation and the payments may be helpful. In general, a private foundation that is established and controlled by an employer violates the requirements of section 501(c)(3) if it provides benefits to a class of beneficiaries composed exclusively of the employer's employees, and such benefits are a form of compensation. The Internal Revenue Service recently held in a private letter ruling,[43] and in similar rulings, that a private foundation that is established, funded and controlled by a particular employer for the purpose of providing disaster relief for employees of a particular employer does not qualify as a charitable organization under section 501(c)(3), because the foundation is not operated solely for charitable purposes and is providing a benefit on behalf of the employer in violation of the prohibition on private inurement. Although private letter rulings do not constitute precedent for other taxpayers, considerable uncertainty exists regarding IRS' position relating to employer-controlled private foundations making disaster relief payments to employee-beneficiaries.

If payments in connection with a qualified disaster are made by a private foundation to employees (and their family members) of an employer that controls the foundation, the presumption that the charity acts consistently with the requirements of section 501(c)(3) applies if the class of beneficiaries is large or indefinite and if recipients are selected based on an objective determination of need by an independent committee of the private foundation, a majority of the members of which are persons other than persons who are in a position to exercise substantial influence over the affairs of the controlling employer (determined under principles similar to those in effect under section 4958). The presumption does not apply to grants made to, or for the benefit of, a disqualified person or member of the selection committee. However, the absence of an independent selection committee does not necessarily mean that a foundation violates the requirements of section 501(c)(3). Other procedures and standards may be adequate substitutes to ensure that

[43] Priv. Ltr. Rul. 199914040.

any benefit to the employer is incidental and tenuous. Similarly, providing need-based payments to employees and their survivors in response to a disaster other than a qualified disaster may well further charitable purposes consistent with the requirements of section 501(c)(3).

The Committee intends that an employer-controlled private foundation is not providing an inappropriate benefit and is not disqualified from exemption under section 501(c)(3) if it makes a payment to an employee or a family member of an employee (who is employed by an employer who controls the foundation) that relieves distress caused by a qualified disaster as defined under section 139, provided that it awards grants based on an objective determination of need using either an independent selection committee or adequate substitute procedures, as described above. The Committee further intends that section 102(c) of the Code, which provides that a transfer from an employer to, or for the benefit of, an employee generally is not excludable from income as a gift, does not apply to such payments. The Committee further expects that the Service will reconsider the ruling position it has taken to ensure that private foundations established and controlled by employers will have appropriate guidance, consistent with the principles outlined above, on the circumstances under which they may provide disaster assistance in connection with a qualified disaster specifically to the employers' employees.

The Committee intends that the making by a private foundation of disaster relief payments that qualify for the presumption stated above (1) will not be treated as an act of self-dealing under section 4941 merely because the recipient is an employee (or family member of an employee) of a disqualified person with respect to the foundation, (2) will be treated as in furtherance of section 170(c)(2)(B) purposes, and (3) will be considered to meet the requirements of section 4945(g) to the extent that they apply. Moreover, contributions to a section 501(c)(3) organization administering relief in a manner outlined above (including those made by employers and any of their employees) are deductible under the generally applicable rules of section 170. Finally, the Committee confirms that need-based payments made by an employer-controlled foundation for exclusively charitable purposes generally are excludable from the recipients' income as gifts.[44] Thus, such payments made by a foundation to relieve distress caused by a qualified disaster are excludable from the recipients' income regardless of whether they fall within the scope of section 139, or any other such provision of the Code providing for an exclusion. The IRS is directed to issue prompt guidance to taxpayers relating to the requirements applicable to private foundations making disaster assistance payments. The principles discussed above should apply to foundations and public charities providing relief in response to both the September 11, 2001, disaster and future qualified disasters.

EFFECTIVE DATE

The provision applies to taxable years ending on or after September 11, 2001.

[44] See, e.g., Rev. Rul. 99–44, 1999–2 C.B. 549.

2. Authority to postpone certain deadlines and required actions (Sec. 322 of the bill, Sec. 7508A of the Code, and new Sec. 518 and Sec. 4002 of the Employee Retirement Income Security Act of 1974)

PRESENT LAW

In general

In general, the Secretary of the Treasury may prescribe regulations under which a period of up to 120 days may be disregarded for performing various acts under the Internal Revenue Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, for any taxpayer determined by the Secretary to be affected by a Presidentially declared disaster (sec. 7508A).

The suspension of time may apply to the following acts:

(1) Filing any return of income, estate, or gift tax (except employment and withholding taxes);

(2) Payment of any income, estate, or gift tax (except employment and withholding taxes);

(3) Filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court;

(4) Allowance of a credit or refund of any tax;

(5) Filing a claim for credit or refund of any tax;

(6) Bringing suit upon any such claim for credit or refund;

(7) Assessment of any tax;

(8) Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;

(9) Collection of the amount of any liability in respect of any tax;

(10) Bringing suit by the United States in respect of any liability in respect of any tax; and

(11) Any other act required or permitted under the internal revenue laws specified in regulations prescribed by the Secretary of the Treasury.[45]

Individuals may, if they choose, perform any of these acts during the period of suspension.

On September 13, 2001, the IRS issued Notice 2001–61 providing relief to taxpayers affected by the September 11, 2001, terrorist attack. Prior to issuance of this notice, the President had declared certain affected areas to be disaster areas. In addition, on September 14, 2001, the IRS issued Notice 2001–63 providing additional tax relief to taxpayers who found it difficult to meet their tax filing and payment obligations.

Employee benefit plans

Questions have arisen about the scope of section 7508A in relation to employee benefit plans. Some acts related to employee benefit plans are not clearly covered by the suspension. For example, a plan sponsor or plan administrator may be required to provide a notice to plan participants or to make a plan contribution, or a

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[45] Treas. Reg. sec. 301.7508A–1(c)(1)(vii) states, with respect to this clause, that it encompasses "any other act specified in a revenue ruling, revenue procedure, notice, announcement, news release, or other guidance published in the Internal Revenue Bulletin."

plan participant may be required to make a benefit election or take a distribution under the plan. In addition, some acts related to employee benefit plans may be required or provided for under the Employee Retirement Income Security Act (ERISA) or under the terms of the plan, rather than under the Internal Revenue Code. For example, on September 14, 2001, the Department of Labor issued News Release No. 01–36, announcing that the Pension and Welfare Benefits Administration, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation were extending the deadline for filing Form 5500 and Form 5500–EZ.

EXPLANATION OF PROVISION

In general

The bill redrafts section 7508A to expand its scope and to clarify its application. Specifically, the bill permits the Secretary to suspend the period of time under this provision for up to one year (increased from up to 120 days). The bill also clarifies that interest on underpayments may be waived or abated pursuant to section 7508A with respect to either a declared disaster or a terroristic or military action. The bill clarifies that the Secretary of the Treasury has the authority to postpone actions pursuant to section 7508A in response to a terroristic or military action, regardless of whether that action has been designated as a disaster area by the President. The bill facilitates the prompt issuance of guidance by the Secretary of the Treasury with respect to section 7508A by removing the requirement that regulations be published listing the scope of additional actions that may be postponed pursuant to section 7508(a)(1)(K); accordingly, the Secretary may provide authoritative guidance via a notice or other mechanism of the Secretary's choice that may be issued more rapidly. It is intended that the Secretary construe this authority as broadly as is necessary and appropriate to respond to specific disasters or terroristic or military actions. The authority to postpone "any . . . act" is sufficiently broad to encompass, for example, specific deadlines enumerated in the Code, such as those in section 1031 (relating to the exchange of property held for productive use or investment). Similarly, it is intended that the Secretary utilize this authority to address issues that arise from the discovery of tax information subsequent to the filing of a tax return that would affect the tax liability reported on that return.

Employee benefit plans

The bill expands and clarifies the scope of the deadlines and required actions that may be postponed pursuant to section 7508A. The bill provides that the Secretary of the Treasury may prescribe a period of up to one year which may be disregarded in determining the date by which any action by a pension or other employee benefit plan, or by a plan sponsor, administrator, participant, beneficiary or other person would be required or permitted to be completed. The bill provides similar authority to the Secretary of Labor and the Pension Benefit Guaranty Corporation with respect to actions within their respective jurisdictions.

The bill is not limited to actions under the Internal Revenue Code. Accordingly, actions under ERISA or under the terms of the plan come within the scope of this provision. Acts performed within the extended period are considered timely under the Internal Revenue Code, ERISA, and the plan. In addition, a plan is not treated as operating in a manner inconsistent with its terms or in violation of its terms merely because acts provided for under the plan are performed during the extended period.

Examples of acts covered by the provision include (1) the filing of a form with the IRS, Department of Labor or the Pension Benefit Guaranty Corporation, (2) an employer's contribution to the plan of required quarterly amounts for the current year or the prior year minimum funding amounts, (3) the filing of an application for a waiver of the minimum funding standard, (4) the payment of premiums to the Pension Benefit Guarantee Corporation, (5) a participant's election of a form of benefits under a plan, (6) the plan administrator's distribution of benefits in accordance with a participant's election, (7) notice to an employee of eligibility for continuation coverage under a group health plan, and (8) an employee's election of continuation coverage.

EFFECTIVE DATE

The provision applies to disasters and terroristic or military actions occurring on or after September 11, 2001, with respect to any action of the Secretary of the Treasury, the Secretary of Labor, or the Pension Benefit Guaranty Corporation on or after the date of the enactment.

3. Internal Revenue Service Disaster Response Team (Sec. 323 of the bill and Sec. 7508A of the Code)

PRESENT LAW

Present law does not contain any provision establishing a permanent Internal Revenue Service Disaster Response Team.

EXPLANATION OF PROVISION

The bill directs the Secretary to create in the IRS a permanent Disaster Response Team, which, in coordination with the Federal Emergency Management Agency, is to assist taxpayers in clarifying and resolving tax matters associated with a Presidentially declared disaster or a terroristic or military action. The Disaster Response Team is to be staffed by IRS employees with relevant knowledge and experience, including a representative from the Office of the Taxpayer Advocate. The Disaster Response Team is to staff a toll-free number dedicated to responding to taxpayers affected by a Presidentially declared disaster or a terroristic or military action and would provide relevant information via the IRS website.

EFFECTIVE DATE

The provision is effective on the date of enactment.

4. Application of certain provisions to terroristic activity (Sec. 324 of the bill and Secs. 101, 104, and 692 of the Code)

PRESENT LAW

Death benefits

Gross income generally does not include the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injury (including death) or sickness (sec. 104(a)(2)). Further, gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract if such amounts are paid by reason of the death of the insured (sec. 101(a)).

Gifts are not includible in gross income. Factual issues may arise as to whether a payment in the context of a business relationship is a gift or taxable compensation for services. In general, payments made by an employer to, or for the benefit of, an employee are not excluded from gross income as gifts (sec. 102(c)).

Taxation of disability income of U.S. employees related to terrorist activity outside the United States

Gross income does not include amounts received by an individual as disability income attributable to injuries incurred as a direct result of a terrorist attack (as determined by the Secretary of State) which occurred while the individual was performing official duties as an employee of the United States outside the United States (sec. 104(a)(5)).

Income tax relief for military and civilian U.S. employees who die as a result of terrorist activity outside the United States

Military and civilian employees of the United States who die as a result of wounds or injury incurred outside the United States in a terroristic or military action are not subject to income tax for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury were incurred. Accordingly, if such an individual is injured and dies in the same taxable year, this exemption from income tax is available for the taxable year of death as well as the prior taxable year.

EXPLANATION OF PROVISION

Death benefits paid in connection with terrorist or military action

Because of the restriction in section 102(c) that a transfer from an employer to an employee generally is not a gift, questions have arisen as to whether extraordinary death benefits paid by an employer by reason of the death of an employee as a result of a terrorist or military action would be taxable. The bill generally provides an exclusion from gross income for amounts received (whether in a single sum or otherwise) by reason of the death of an employee incurred as a result of a terroristic or military action.

The exclusion applies only to the extent that the amounts so paid exceed the amount of benefits that would have been payable if the death had occurred by reason of an event other than the terroristic or military action. For example, the exclusion does not apply to amounts received under a qualified retirement plan or nonqualified deferred compensation plan to the extent such amounts would have been payable if the death had occurred for any other reason. The otherwise applicable rules apply to amounts not excluded under the provision. The exclusion applies to benefits payable under a plan solely as a result of death from a terroristic or military action. No change to present law is intended as to the deductibility of death benefits paid by the employer or otherwise merely because the payments are excludable by the recipient.

The bill provides that the exclusion does not apply with respect to any individual identified by the Attorney General to have been a participant or conspirator in the terrorist-related aircraft crashes of September 11, 2001, or any other terrorist attack, or a representative of such an individual.

Other payments, in addition to those by employers, may be made to the survivors of the victims of the September 11 attack on the United States. No statutory change is being made with respect to those payments because the present-law rules regarding gifts are sufficient to exclude such payments from gross income, regardless of a business relationship between the payor and the decedent.

The bill is not intended to narrow the scope of any applicable exclusion under present law. Accordingly, payments that are not specifically excludable under the bill remain excludable to the same extent provided under present law.

In connection with the September 11, 2001, terrorist attacks, insurance companies may pay death benefits under a life insurance contract even if the contract terms provide for an exclusion for death occurring as a result of an act of terrorism or act of war. It is understood that such a death benefit payment would fall within the present-law exclusion (under sec. 101(a)) for payments made under the contract if it otherwise meets the requirements of the present-law exclusion.

Taxation of disability income related to terrorist activity

The bill expands the present-law exclusion from gross income for disability income of U.S. civilian employees attributable to a terrorist attack outside the United States to apply to disability income received by any nonmilitary individual attributable to a terroristic or military action. The bill is not intended to apply to amounts that would have been payable even if the individual had not become disabled as a result of a terrorist or military action.

Income tax relief for individuals who die as a result of terrorist activity

The bill extends the income tax relief provided under present law to U.S. military and civilian personnel who die as a result of terroristic activity or military action outside the United States to such personnel regardless of where the terroristic activity or military action occurred.

EFFECTIVE DATE

The provision is effective for taxable years ending on or after September 11, 2001.

5. Clarification of due date for airline excise tax deposits (Sec. 325 of the bill and Sec. 301 of the Air Transportation Safety And Stabilization Act)

PRESENT LAW

Section 301 of the Air Transportation Safety and System Stabilization Act[46] provides a special rule for the deposit of certain taxes. If a deposit of these taxes was required to be made after September 10, 2001, and before November 15, 2001, they are treated as timely made if deposited by November 15, 2001. The Secretary of the Treasury is given the authority to extend this deadline further, but no later than January 15, 2002. For eligible air carriers, the special deposit rules are applicable to the excise taxes imposed on air travel. The special deposit rules were also applied inadvertently to the deposit of the following employment taxes: both the employer and employee portions of FICA, railroad retirement taxes, and income taxes withheld by employers from employees.

EXPLANATION OF PROVISION

The applicability of these special deposit rules to employment taxes is repealed. The applicability of these special deposit rules to excise taxes is unaffected. It is intended that no penalties be imposed with respect to taxes that were not deposited timely in reliance on the provisions of the Air Transportation Safety and System Stabilization Act prior to the enactment of this provision.

EFFECTIVE DATE

The provision is effective as if included in section 301 of the Air Transportation Safety and System Stabilization Act.

6. Coordination with Air Transportation Safety and System Stabilization Act (Sec. 326 of the bill)

PRESENT LAW

Title IV of the Air Transportation Safety and System Stabilization Act[47] provides compensation to individuals (or relatives of deceased individuals) who were physically injured or killed as a result of the terrorist-related aircraft crashes of September 11, 2001. The amount of compensation to which a claimant is otherwise entitled under the Air Transportation Safety and System Stabilization Act is reduced by the amount of collateral source compensation the claimant has received or is entitled to receive as a result of the terrorist-related aircraft crashes of September 11, 2001. Section 402(4) of the Air Transportation Safety and System Stabilization Act defines "collateral source" as all collateral sources, including life insurance, pension funds, death benefit programs, and payments by Federal, State, or local governments related to the terrorist-related aircraft crashes of September 11, 2001.

[46] Pub. L. No. 107–42.
[47] Pub. L. No. 107–42.

EXPLANATION OF PROVISION

Because there has been no guidance defining the scope of the term "collateral source" under the Air Transportation Safety and System Stabilization Act, questions may arise as to whether tax benefits are considered collateral payments. The bill clarifies that the tax benefits provided under the bill are not to be considered as being received from a collateral source for purposes of section 402(4) of the Air Transportation Safety and System Stabilization Act. Thus, the tax benefits provided under the bill do not reduce the amount of compensation to which a claimant is otherwise entitled under the Air Transportation Safety and System Stabilization Act. No inference is intended that any other tax benefits are payments from a collateral source for purposes of the Air Transportation Safely System Stabilization Act.

EFFECTIVE DATE

The provision is effective on the date of enactment.

D. Disclosure of Tax Information in Terrorism and National Security Investigations

(Sec. 331 of the bill and Sec. 6103 of the Code)

PRESENT LAW

In general

Returns and return information are confidential (sec. 6103). A "return" is any tax return, information return, declaration of estimated tax, or claim for refund filed under the Code on behalf of or with respect to any person. The term return also includes any amendment or supplement, including supporting schedules, attachments, or lists, which are supplemental to or are part of a filed return. Return information is defined broadly. It includes the following information:

- a taxpayer's identity, the nature, source or amount of income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments;
- whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing;
- any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense;
- any part of any written determination or any background file document relating to such written determination which is not open to public inspection under Code section 6110;
- any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to the agreement or any application for an advance pricing agreement; and

- any agreement under Code section 7121 (relating to closing agreements), and any similar agreement, and any background information related to such agreement or request for such agreement (Code sec. 6103(b)(2).

The term "return information" does not include data in a form that cannot be associated with or otherwise identify, directly or indirectly, a particular taxpayer. "Taxpayer return information" means return information which is filed with, or furnished to, the Internal Revenue Service by or on behalf of the taxpayer to whom such return information relates.

Code section 6103 provides that returns and return information may not be disclosed by the Internal Revenue Service ("IRS"), other Federal employees, State employees, and certain others having access to the information except as provided in the Internal Revenue Code. 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.

Recordkeeping and safeguard requirements also are imposed. These requirements establish a system of records to keep track of disclosure requests and disclosures, ensure that the information is securely stored and access to the information is restricted to authorized persons. These conditions and safeguards are intended to ensure that an individual's right to privacy is not unduly compromised and the information is not misused or improperly disclosed. The IRS also must submit reports to the Joint Committee on Taxation and to the public regarding requests for and disclosures made of returns and return information 90 days after the close of the calendar year (Code sec. 6103(p)(3)). Criminal and civil sanctions apply to the unauthorized disclosure or inspection of returns and return information (Code secs. 7213, 7213A, and 7431).

Disclosure of returns and return information for use in nontax criminal investigations—by ex parte court order

A Federal agency enforcing a nontax criminal law must obtain an ex parte court order to receive a return or taxpayer return information (i.e., that information submitted by or on behalf of a taxpayer to the IRS) (Code sec. 6103(i)(1)).[48] Only the Attorney General, Deputy Attorney General, Assistant Attorney Generals, United States Attorneys, Independent Counsels, or an attorney in charge of an organized crime strike force may authorize an application for the order.

For a judge or magistrate to grant such an order, the application must demonstrate that:

- there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed;
- there is reasonable cause to believe that the return or return information is or may be relevant to a matter relating to the commission of such act;

[48] Return information other than that submitted by the taxpayer may be obtained by ex parte court order under this provision as well.

- the return or return information is sought exclusively for use in a Federal criminal investigation or proceeding concerning such act; and
- the information sought reasonably cannot be obtained, under the circumstances, from another source.

Pursuant to the *ex parte* order, the information may be disclosed to officers and employees of the Federal agency who are personally and directly engaged in (1) the preparation for any judicial or administrative proceeding pertaining to the enforcement of a specifically designated Federal criminal statute (not involving tax administration) to which the United States or such agency is a party, (2) any investigation which may result in such a proceeding, or (3) any Federal grand jury proceeding pertaining to enforcement of such a criminal statute to which the United States or such agency is or may be a party.

A Federal agency may obtain, by *ex parte* court order, the return and return information of a fugitive from justice for purposes of locating such individual (Code sec. 6103(i)(5)). The application for an *ex parte* order must establish that (1) a Federal felony arrest warrant has been issued and the taxpayer is a fugitive from justice, (2) the return or return information is sought exclusively for locating the fugitive taxpayer, and (3) reasonable cause exists to believe the information may be relevant in determining the location of the fugitive. Only the Attorney General, Deputy Attorney General, Assistant Attorney Generals, United States Attorneys, Independent Counsels, or an attorney in charge of an organized crime strike force may authorize an application for this order. Once a court grants the application for an *ex parte* order, the return or return information may be disclosed to any Federal agency exclusively for purposes of locating the fugitive individual.

Agency request procedure for disclosure of return information other than that provided by the taxpayer to the IRS for use in criminal investigations

For nontax criminal investigations, Federal agencies can obtain return information, other than taxpayer return information, without a court order. For nontax criminal purposes, the head of a Federal agency and other persons specifically identified by Code section 6103 may make a written request for return information that was not provided to the IRS by the taxpayer or his representative (Code sec. 6103(i)(2)). The written request must contain:

- the taxpayer's name, and address;
- the taxable period for which the information is sought;
- the statutory authority under which the criminal investigation or judicial, administrative or grand jury proceeding is being conducted; and
- the reasons why such disclosure is or may be relevant to the investigation or proceeding. Unlike the requirements for an *ex parte* order, the requesting agency does not have to demonstrate that the information sought is not reasonably available elsewhere.

Disclosure of return information to apprise appropriate officials of criminal activities or emergency circumstances

Criminal activities

Section 6103 permits the IRS to disclose return information (other than taxpayer return information) that may be evidence of a crime (Code sec. 6103(i)(3)(A)). The IRS may make the disclosure in writing to the head of a Federal agency charged with enforcing the laws to which the crime relates. Return information also may be disclosed to apprise Federal law enforcement of the imminent flight of any individual from Federal prosecution. The IRS may not disclose returns under this provision.

Emergency circumstances

In cases of imminent danger of death or physical injury to an individual, the IRS may disclose return information to Federal and State law enforcement agencies (Code sec. 6103(i)(3)(B)). The statute does not grant authority, however, to disclose return information to local law enforcement, such as city, county, or town police. The statute does not permit the IRS to disclose return information concerning terrorist activities if there is no imminent danger of death or physical injury to an individual.

Tax convention information

With limited exceptions, the Code prohibits the disclosure of tax convention information (sec. 6105). A tax convention is any: (1) income tax or gift and estate tax convention, or (2) other convention or bilateral agreement (including multilateral conventions and agreements and any agreement with a possession of the United States) providing for the avoidance of double taxation, the prevention of fiscal evasion, nondiscrimination with respect to taxes, the exchange of tax relevant information with the United States, or mutual assistance in tax matters. Tax convention information is any: (1) agreement entered into with the competent authority of one or more foreign governments pursuant to a tax convention; (2) application for relief under a tax convention; (3) background information related to such agreement or application; (4) document implementing such agreement; and (5) other information exchanged pursuant to a tax convention which is treated as confidential or secret under the tax convention.

The general rule that tax convention information cannot be disclosed does not apply to the disclosure of tax convention information to persons or authorities (including courts and administrative bodies) that are entitled to disclosure under the tax convention and any generally applicable procedural rules regarding applications for relief under a tax convention. It also does not apply to the disclosure of tax convention information not relating to a particular taxpayer if the IRS determines, after consultation with the parties to the tax convention, that such disclosure would not impair tax administration.

EXPLANATION OF PROVISION

The bill expands the availability of returns and return information for purposes of investigating terrorist activity or threats, and for analyzing intelligence concerning terrorist activity, terrorist organizations, and terrorists. In general, under the bill, returns and return information provided by the taxpayer or his or her representative to the IRS 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. Present-law safeguards, recordkeeping, reporting requirements, and civil and criminal penalties for unauthorized disclosures apply to disclosures made pursuant to the bill. The bill also permits the disclosure of tax convention information for the same purposes and in the same manner that return information is made available under the bill. No disclosures could be made under the bill after December 31, 2003.

Disclosure of returns and return information including taxpayer return information—by ex parte court order

Ex parte court orders sought by Federal law enforcement and Federal intelligence agencies.—The bill 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, response to, or analysis of intelligence and counterintelligence information concerning any terrorist activity or threats. 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 activity or threat.

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:

- 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 activity or threat; and
- the return or return information is sought exclusively for the use in a Federal investigation, analysis, or proceeding concerning terrorist activity, terrorist threats or terrorist organizations.

Special rule for ex parte court ordered disclosure initiated by the IRS.—If the Secretary of Treasury possesses returns or return information that may be related to a terrorist incident, threat or activity, the Secretary of the Treasury (or his delegate), 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 activity or threat. Under the bill, 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 terrorist activity, terrorist threats, or terrorist organizations. Because the Department of Justice represents the Secretary of the Treasury 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 taxpayer return information

Disclosure by the IRS without a request.—The bill permits the IRS to disclose return information, other than that supplied by the taxpayer, 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. This rule applies to information received from third parties, such as banks. As under present law Code section 6103(i)(3)(A), 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 bill permits the IRS to disclose return information, other than that supplied by the taxpayer, 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 bill 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 Treasury for intelligence analysis of terrorist activity.—Upon written request satisfying certain requirements discussed below, the IRS is to disclose return information (other than that obtained from the taxpayer[49]) to officers and employees of the Department of Justice, Department of Treasury, and other Federal intelligence agencies, who are personally and directly engaged in the collection or analysis of intelligence and counterintelligence or investigation concerning terrorists and terrorist organizations and 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, activity or threat. 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 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 terrorists and terrorist organizations and activities. The Director of the United States Secret Service also is an authorized requester under the bill.

Tax convention information

The bill permits the disclosure of tax convention information on the same terms as return information may be disclosed under the bill, except that in the case of tax convention information provided by a foreign government, no disclosure may be made under this paragraph without the written consent of the foreign government.

EFFECTIVE DATE

The provision is effective for disclosures made on or after the date of enactment.

V. EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

A. EXTEND ALTERNATIVE MINIMUM TAX RELIEF FOR INDIVIDUALS

(Sec. 401 of the bill and Sec. 26 of the Code)

PRESENT LAW

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[50], the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the IRA credit, and the D.C. homebuyer's credit). For taxable years beginning after 2001, these credits (other than the adoption credit, child credit and IRA 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 IRA credit are allowed to the full extent of the individual's regular tax and alternative minimum tax.

For taxable years beginning in 2001, all the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

[49] A taxpayer's identity is not treated as having been supplied by the taxpayer or his representative.

[50] A portion of the child credit may be refundable.

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 an amount equal to (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent of the remaining AMTI. The maximum tax rates on net capital gain used in computing the tentative minimum tax are the same as under the regular tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments. The exemption amounts are: (1) $45,000 ($49,000 in taxable years beginning before 2005) in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 ($35,750 in taxable years beginning before 2005) in the case of other unmarried individuals; (3) $22,500 ($24,500 in taxable years beginning before 2005) in the case of married individuals filing a separate return; and (4) $22,500 in the case of an estate or trust. The exemption amounts are 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.

REASONS FOR CHANGE

The Committee believes that the nonrefundable personal credits should be useable without limitation by reason of the alternative minimum tax. This will result in significant simplification.

EXPLANATION OF PROVISION

The provision allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the personal nonrefundable credits in 2002.

EFFECTIVE DATE

The provision is effective for taxable years beginning in 2002.

B. EXTEND THE WORK OPPORTUNITY TAX CREDIT

(Sec. 402 of the bill and Sec. 51 of the Code)

PRESENT LAW

In general

The work opportunity tax credit ("WOTC") is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The credit equals 40 percent (25 percent for employment of less than 400 hours) of qualified wages. Generally, qualified wages are wages 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.

The maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). 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).

For purposes of the credit, wages are generally defined as under the Federal Unemployment Tax Act, without regard to the dollar cap.

Targeted groups eligible for the credit

The eight targeted groups are: (1) families eligible to receive benefits under the Temporary Assistance for Needy Families ("TANF") Program; (2) high-risk youth; (3) qualified ex-felons; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; (7) families receiving food stamps; and (8) persons receiving certain Supplemental Security Income ("SSI") benefits.

The employer's deduction for wages is reduced by the amount of the credit.

Expiration date

The credit is effective for wages paid or incurred to a qualified individual who begins work for an employer before January 1, 2002.

REASONS FOR CHANGE

The Committee believes that a temporary extension of this credit will allow the Congress and the Treasury and Labor Departments to continue to monitor the effectiveness of the credit.

EXPLANATION OF PROVISION

The bill extends the work opportunity tax credit for one year (through December 31, 2002).

EFFECTIVE DATE

The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 2002, and before January 1, 2003.

C. Extend the Welfare-To-Work Tax Credit

(Sec. 403 of the bill and Sec. 51A of the Code)

PRESENT LAW

In general

The welfare-to-work tax credit is available on an elective basis for employers for the first $20,000 of eligible wages paid to qualified long-term family assistance recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The maximum credit is $8,500 per qualified employee.

Qualified long-term family assistance recipients are: (1) members of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received family assistance for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit if they are hired within 2 years after the date that the 18-month total is reached; and (3) members of a family that is no longer eligible for family assistance because of either Federal or State time limits, if they are hired within two years after the Federal or State time limits made the family ineligible for family assistance. Family assistance means benefits under the Temporary Assistance to Needy Families ("TANF") program.

For purposes of the credit, wages are generally defined under the Federal Unemployment Tax Act, without regard to the dollar amount. In addition, wages include the following: (1) educational assistance excludable under a section 127 program; (2) the value of excludable health plan coverage but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

The employer's deduction for wages is reduced by the amount of the credit.

Expiration date

The welfare to work credit is effective for wages paid or incurred to a qualified individual who begins work for an employer before January 1, 2002.

REASONS FOR CHANGE

The Committee believes that the welfare-to-work credit should be temporarily extended to provide the Congress and Treasury and Labor Departments a better opportunity to assess the operation and effectiveness of the credit in meeting its goals. These goals are: (1) to provide an incentive to hire long-term welfare recipients; (2) to promote the transition from welfare to work by increasing access to employment for these individuals; and (3) to encourage employers to provide these individuals with training, health coverage, dependent care and ultimately better job attachment.

EXPLANATION OF PROVISION

The bill extends the welfare to work credit for one year (through December 31, 2002).

EFFECTIVE DATE

The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 2002, and before January 1, 2003.

D. EXTEND SECTION 45 CREDIT FOR PRODUCTION OF ELECTRICITY FROM WIND, CLOSED LOOP BIOMASS, AND POULTRY LITTER

(Sec. 404 of the bill and Sec. 45 of the Code)

PRESENT LAW

An income tax credit is allowed for the production of electricity from either qualified wind energy, qualified "closed-loop" biomass, or qualified poultry waste facilities (sec. 45).

The credit applies to electricity produced by a wind energy facility placed in service after December 31, 1993, and before January

1, 2002, to electricity produced by a closed-loop biomass facility placed in service after December 31, 1992, and before January 1, 2002, and to a poultry waste facility placed in service after December 31, 1999, and before January 1, 2002. The credit is allowable for production during the 10-year period after a facility is originally placed in service. In order to claim the credit, a taxpayer must own the facility and sell the electricity produced by the facility to an unrelated party. In the case of a poultry waste facility, the taxpayer may claim the credit as a lessee/operator of a facility owned by a governmental unit.

Closed-loop biomass is plant matter, where the plants are grown for the sole purpose of being used to generate electricity. It does not include waste materials (including, but not limited to, scrap wood, manure, and municipal or agricultural waste). The credit also is not available to taxpayers who use standing timber to produce electricity. Poultry waste means poultry manure and litter, including wood shavings, straw, rice hulls, and other bedding material for the disposition of manure.

The credit for electricity produced from wind, closed-loop biomass, or poultry waste is a component of the general business credit (sec. 38(b)(8)). The credit, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000, or (2) the tentative minimum tax. For credits arising in taxable years beginning after December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39). To coordinate the carryback with the period of application for this credit, the credit for electricity produced from closed-loop biomass facilities may not be carried back to a tax year ending before 1993 and the credit for electricity produced from wind energy may not be carried back to a tax year ending before 1994 (sec. 39).

REASONS FOR CHANGE

The Committee believes that continued economic incentive is warranted to increase the presence of these more environmentally friendly generation sources in the nation's electricity grid.

EXPLANATION OF PROVISION

The bill extends the placed in service date for qualified facilities by one year to include those facilities placed in service prior to January 1, 2003.

EFFECTIVE DATE

The provision is effective on the date of enactment.

E. Taxable Income Limit on Percentage Depletion for Marginal Production

(Sec. 405 of the bill and Sec. 613A of the Code)

PRESENT LAW

In general

Depletion, like depreciation, is a form of capital cost recovery. In both cases, the taxpayer is allowed a deduction in recognition of the fact that an asset—in the case of depletion for oil or gas interests, the mineral reserve itself—is being expended in order to produce income. Certain costs incurred prior to drilling an oil or gas property are recovered through the depletion deduction. These include costs of acquiring the lease or other interest in the property and geological and geophysical costs (in advance of actual drilling). Depletion is available to any person having an economic interest in a producing property.

Two methods of depletion are allowable under the Code: (1) the cost depletion method, and (2) the percentage depletion method (secs. 611–613). Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the depletable property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining as of the end of taxable year plus the number of units sold during the taxable year. Thus, the amount recovered under cost depletion may never exceed the taxpayer's basis in the property.

Under the percentage depletion method, generally, 15 percent of the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year (sec. 613A(c)). The amount deducted generally may not exceed 100 percent of the net income from that property in any year (the "net-income limitation") (sec. 613(a)). The Taxpayer Relief Act of 1997 suspended the 100-percent-of-net-income limitation for production from marginal wells for taxable years beginning after December 31, 1997, and before January 1, 2000. The limitation subsequently was extended to include taxable years beginning before January 1, 2002. Additionally, the percentage depletion deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income (determined before such deduction and adjusted for certain loss carrybacks and trust distributions) (sec. 613A(d)(1)).[51] Because percentage depletion, unlike cost depletion, is computed without regard to the taxpayer's basis in the depletable property, cumulative depletion deductions may be greater than the amount expended by the taxpayer to acquire or develop the property.

A taxpayer is required to determine the depletion deduction for each oil or gas property under both the percentage depletion method (if the taxpayer is entitled to use this method) and the cost depletion method. If the cost depletion deduction is larger, the taxpayer must utilize that method for the taxable year in question (sec. 613(a)).

[51] Amounts disallowed as a result of this rule may be carried forward and deducted in subsequent taxable years, subject to the 65-percent taxable income limitation for those years.

Limitation of oil and gas percentage depletion to independent producers and royalty owners

Generally, only independent producers and royalty owners (as contrasted to integrated oil companies) are allowed to claim percentage depletion. Percentage depletion for eligible taxpayers is allowed only with respect to up to 1,000 barrels of average daily production of domestic crude oil or an equivalent amount of domestic natural gas (sec. 613A(c)). For producers of both oil and natural gas, this limitation applies on a combined basis.

In addition to the independent producer and royalty owner exception, certain sales of natural gas under a fixed contract in effect on February 1, 1975, and certain natural gas from geopressured brine, are eligible for percentage depletion, at rates of 22 percent and 10 percent, respectively. These exceptions apply without regard to the 1,000-barrel-per-day limitation and regardless of whether the producer is an independent producer or an integrated oil company.

REASONS FOR CHANGE

The Committee notes that oil is, and will continue to be, vital to the American economy. The Committee believes that extension of the current waiver of the 100-percent-of-income-limit will contribute to investment in domestic oil and gas production.

EXPLANATION OF PROVISION

The provision extends the period when the 100-percent net-income limit is suspended to include the taxable year 2002.

EFFECTIVE DATE

The provision is effective on the date of enactment.

F. EXTENSION OF AUTHORITY TO ISSUE QUALIFIED ZONE ACADEMY BONDS

(Sec. 406 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 (sec. 103).

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments are given the authority to issue "qualified zone academy bonds" ("QZABs") (sec. 1397E). A total of $400 million of qualified zone academy bonds may be issued annually in calendar years 1998 through 2001. 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 AMT 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 is 50 percent of the face value of the bond.

"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 zones 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.

REASONS FOR CHANGE

The Committee believes that extension of authority to issue qualified zone academy bonds is appropriate in light of the educational needs that exist today.

EXPLANATION OF PROVISION

The provision authorizes issuance of up to $400 million of qualified zone academy bonds annually in calendar year 2002.

EFFECTIVE DATE

The provision is effective on the date of enactment.

G. One-Year Extension of Exceptions under Subpart F for Active Financing Income

(Sec. 407 of the bill and Secs. 953 and 954 of the Code)

PRESENT LAW

Under the subpart F rules, 10-percent U.S. shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, foreign personal holding company income and insurance income. In addition, 10-percent U.S. shareholders of a CFC are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (i.e., income derived from services performed for a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and REMICs; (3) net gains from commodities transactions; (4) net gains from foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; and (7) payments in lieu of dividends.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income (Prop. Treas. Reg. sec. 1.953–1(a)).

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business (so-called "active financing income").[52]

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the ex-

[52] Temporary exceptions from the subpart F provisions for certain active financing income applied only for taxable years beginning in 1998. Those exceptions were modified and extended for one year, applicable only for taxable years beginning in 1999. The Tax Relief Extension Act of 1999 (P.L. No. 106–170) clarified and extended the temporary exceptions for two years, applicable only for taxable years beginning after 1999 and before 2002.

ceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of insurance, in addition to a temporary exception from foreign personal holding company income for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization, certain temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met.

REASONS FOR CHANGE

In the Taxpayer Relief Act of 1997, one-year temporary exceptions from foreign personal holding company income were enacted for income from the active conduct of an insurance, banking, financing, or similar business.[53] In the Tax and Trade Relief Extension Act of 1998, the Congress extended the temporary exceptions for an additional year, with certain modifications designed to treat various types of businesses with active financing income more similarly to each other than did the 1997 provision.[54] In the Tax Relief Extension Act of 1999, Congress extended the temporary extensions for an additional two years, as modified by the 1998 Act, and with a clarification relating to the application of prior law in the event of future non-application of the temporary provisions.[55] The Committee believes that it is appropriate to extend the temporary provisions for an additional year, as modified by the previous legislation.

EXPLANATION OF PROVISION

The provision extends for one year the present-law temporary exceptions from subpart F foreign personal holding company income,

[53] The President canceled this provision in 1997 pursuant to the Line Item Veto Act. On June 25, 1998, the U.S. Supreme Court held that the cancellation procedures set forth in the Line Item Veto Act are unconstitutional. *Clinton v. City of New York*, 524 U.S. 417 (1998).

[54] The Tax and Trade Relief Extension Act of 1998, Division J, Making Omnibus Consolidated and Emergency Supplemental Appropriations for Fiscal Year 1999, P. L. No. 105–277, sec. 1005 (1998).

[55] The Tax Relief Extension Act of 1999, P.L. No. 106–170, sec. 503 (1999).

foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2001, and before January 1, 2003, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

H. Extension of Increased Coverover Payments to Puerto Rico and the Virgin Islands

(Sec. 408 of the bill and Sec. 7652 of the Code)

PRESENT LAW

A $13.50 per proof gallon[56] excise tax is imposed on distilled spirits produced in, or imported or brought into, the United States. The excise tax does not apply to distilled spirits that are exported from the United States or to distilled spirits that are consumed in U.S. possessions (e.g., Puerto Rico and the Virgin Islands).

The Code provides for coverover (payment) of $13.25 per proof gallon of the excise tax imposed on rum imported (or brought) into the United States (without regard to the country of origin) to Puerto Rico and the Virgin Islands during the period July 1, 1999 through December 31, 2001. Effective on January 1, 2002, the coverover rate is scheduled to return to its permanent level of $10.50 per proof gallon.

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.

REASONS FOR CHANGE

The Committee believes that extension of the increased coverover rate to Puerto Rico and the Virgin Islands will contribute to economic stability in those possessions.

EXPLANATION OF PROVISION

The provision extends the $13.25-per-proof-gallon coverover rate for one additional year, through December 31, 2003.

The Committee is aware that Puerto Rico currently allocates a portion of the coverover payments it receives to the Puerto Rico Conservation Trust. The Committee believes it is appropriate that this allocation continue through the period when the $13.25-per-proof-gallon rate is extended.

EFFECTIVE DATE

The provision is effective on the date of enactment.

[56] A proof gallon is a liquid gallon consisting of 50 percent alcohol.

I. Delay in Effective Date of Requirement for Approved Diesel or Kerosene Terminal

(Sec. 409 of the bill and Sec. 4101 of the Code)

PRESENT LAW

Excise taxes are imposed on highway motor fuels, including gasoline, diesel fuel, and kerosene, to finance the Highway Trust Fund programs. Subject to limited exceptions, these taxes are imposed on all such fuels when they are removed from registered pipeline or barge terminal facilities, with any tax-exemptions being accomplished by means of refunds to consumers of the fuel.[57] One such exception allows removal of diesel fuel or kerosene without payment of tax if the fuel is destined for a nontaxable use (e.g., use as heating oil) and is indelibly dyed.

Terminal facilities are not permitted to receive and store non-tax-paid motor fuels unless they are registered with the Internal Revenue Service. Under present law, a prerequisite to registration is that if the terminal offers for sale diesel fuel, it must offer both dyed and undyed diesel fuel. Similarly, if the terminal offers for sale kerosene, it must offer both dyed and undyed kerosene. This "dyed-fuel mandate" was enacted in 1997, to be effective on July 1, 1998. Subsequently, the effective date was delayed until July 1, 2000, and later until January 1, 2002.

REASONS FOR CHANGE

When the rules governing taxation of kerosene used as a highway motor fuel were enacted n 1997, the Congress was concerned that dyed kerosene and diesel fuel (destined for nontaxable uses) might be unavailable in markets where those fuels were commonly used (e.g., as heating oil). To ensure availability of untaxed, dyed fuels for those uses, the Congress included a requirement that terminals offer both dyed and undyed kerosene and diesel fuel (if they offered the fuels for sale at all) as a condition of receiving untaxed fuels. Since that time, markets have provided dyed kerosene and diesel fuel for nontaxable uses where there is a demand for them. The Committee believes a further delay in this registration requirement is appropriate to allow a more complete evaluation of whether the requirement should be repealed or implemented.

EXPLANATION OF PROVISION

The effective date of the diesel fuel and kerosene dyeing mandate is delayed for one additional year, until January 1, 2003.

EFFECTIVE DATE

The provision is effective on the date of enactment.

[57] Tax is imposed before that point if the motor fuel is transferred (other than in bulk) from a refinery or if the fuel is sold to an unregistered party while still held in the refinery or bulk distribution system (e.g., in a pipeline or terminal facility).

J. Extend Deduction for Qualified Clean-Fuel Vehicle Property and Qualified Clean-Fuel Vehicle Refueling Property

(Sec. 410 of the bill and Secs. 179A and 280F of the Code)

PRESENT LAW

Certain costs of qualified clean-fuel vehicle property and clean-fuel vehicle refueling property may be expensed and deducted when such property is placed in service (sec. 179A).[58] Qualified clean-fuel vehicle property includes motor vehicles that use certain clean-burning fuels (natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity and any other fuel at least 85 percent of which is methanol, ethanol, any other alcohol or ether). The maximum amount of the deduction is $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds or a bus with seating capacities of at least 20 adults; $5,000 in the case of a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. Qualified electric vehicles do not qualify for the clean-fuel vehicle deduction.

Clean-fuel vehicle refueling property comprises property for the storage or dispensing of a clean-burning fuel, if the storage or dispensing is the point at which the fuel is delivered into the fuel tank of a motor vehicle. Clean-fuel vehicle refueling property also includes property for the recharging of electric vehicles, but only if the property is located at a point where the electric vehicle is recharged. Up to $100,000 of such property at each location owned by the taxpayer may be expensed with respect to that location.

The deduction for clean-fuel vehicle property phases down in the years 2002 through 2004, and is unavailable for purchases after December 31, 2004. The deduction for clean-fuel vehicle refueling property is unavailable for property placed in service after December 31, 2004.

REASONS FOR CHANGE

The Committee believes that continued economic incentive is warranted to increase the presence of alternative fuel vehicles in the market.

EXPLANATION OF PROVISION

The bill defers the phase down of the deduction for clean-fuel vehicle property by one year. Taxpayers may claim the full amount of the deduction for qualified vehicles placed in service in 2002. Under the bill, the phase down of the deduction for clean-fuel vehicles commences in 2003 and the deduction is unavailable for purchases after December 31, 2005. A conforming modification is made to section 280F.

[58] The amount the taxpayer may claim as a depreciation deduction for any passenger automobile is limited (sec. 280F). In the case of a qualified clean-burning fuel vehicle, the limitation of sec. 280F applies only to that portion of the vehicle's cost not represented by the installed qualified clean-burning fuel property. The taxpayer may claim an amount otherwise allowable as a depreciation deduction on the installed qualified clean-burning fuel property, without regard to the limitation. These exceptions from sec. 280F apply to vehicles placed in service prior to January 1, 2005.

The provision extends the placed in service date for clean-fuel vehicle refueling property by one year. The deduction for clean-fuel vehicle refueling property is available for property placed in service prior to January 1, 2006.

EFFECTIVE DATE

The provision is effective on the date of enactment.

K. Extend Credit for Purchase of Electric Vehicles

(Sec. 411 of the bill and Secs. 30 and 280F of the Code)

PRESENT LAW

A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000 (sec. 30). A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current, the original use of which commences with the taxpayer, and that is acquired for the use by the taxpayer and not for resale. The full amount of the credit is available for purchases prior to 2002. The credit phases down in the years 2002 through 2004, and is unavailable for purchases after December 31, 2004.[59]

REASONS FOR CHANGE

The Committee believes that continued economic incentive is warranted to increase the presence of electric vehicles on the nation's roadways.

EXPLANATION OF PROVISION

The bill defers the phase down of the credit for one year. Taxpayers may claim the full amount of the credit for qualified purchases made in 2002. Under the bill, the phase down of the credit value commences in 2003 and the credit is unavailable for purchases after December 31, 2005. A conforming modification is made to section 280F.

EFFECTIVE DATE

The provision is effective on the date of enactment.

L. Tax on Failure to Comply with Mental Health Parity Requirements

(Sec. 412 of the bill and Sec. 9812 of the Code)

PRIOR LAW

The Mental Health Parity Act of 1996 amended ERISA and the Public Health Service Act to provide that group health plans that provide both medical and surgical benefits and mental health bene-

[59] The amount the taxpayer may claim as a depreciation deduction for any passenger automobile is limited (sec. 280F). In the case of a passenger vehicle designed to be propelled primarily by electricity and built by an original equipment manufacturer, the otherwise applicable limitation amounts are tripled. These exceptions from sec. 280F apply to vehicles placed in service prior to January 1, 2005.

fits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits. The provisions of the Mental Health Parity Act are effective with respect to plan years beginning on or after January 1, 1998, but do not apply to benefits for services furnished on or after September 30, 2001.

The Taxpayer Relief Act of 1997 added to the Internal Revenue Code the requirements imposed under the Mental Health Parity Act, and imposed an excise tax on group health plans that fail to meet the requirements. The excise tax is equal to $100 per day during the period of noncompliance and is 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 exercising reasonable diligence would not have known, that the failure existed.

The excise tax is applicable with respect to plan years beginning on or after January 1, 1998, and expired with respect to benefits for services provided on or after September 30, 2001.

REASONS FOR CHANGE

The Committee believes it appropriate to extend the mental health parity provisions.

EXPLANATION OF PROVISION

The excise tax on failures to comply with mental health parity requirements is extended for nine months.[60]

EFFECTIVE DATE

The provision is effective with respect to plan years beginning on or after January 1, 2002, and does not apply to benefits for services furnished on or after September 30, 2002.

M. COMBINED EMPLOYMENT TAX REPORTING

(Sec. 413 of the bill, Sec. 6103 of the Code)

PRESENT LAW

The Internal Revenue Code prohibits disclosure of tax 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 pro-

[60] The related provisions of ERISA and the Public Health Service Act, which also expired on September 30, 2001, have not been extended. However, the Senate amendment to H.R. 3061 (providing appropriations for the Departments of Labor, Health and Human Services, and Education for fiscal year 2002) adopts new mental health parity requirements under ERISA and the Public Health Service Act effective beginning in 2003.

cedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

The Taxpayer Relief Act of 1997 authorized a demonstration project to assess the feasibility and desirability of expanding combined reporting. The demonstration project was: (1) limited to the State of Montana, (2) limited to employment taxes, (3) limited to taxpayer identity (name, address, taxpayer identifying number) and the signature of the taxpayer, and (4) limited to a period of five years. After August 5, 2002, the demonstration project will expire.

To implement that demonstration project, the Taxpayer Relief Act of 1997 amended the Code to authorize the IRS to disclose the name, address, taxpayer identifying number, and signature of the taxpayer, which is common to both the State and Federal portions of the combined form. The Code permits the IRS to disclose these common data items to the State and not have it subject to the redisclosure restrictions, safeguards, or criminal penalty provisions.[61] Essentially, the State is allowed to use this information as if the State directly received this information from the taxpayer.

REASONS FOR CHANGE

The IRS has found the demonstration project to be successful; therefore the Committee believes a further extension of authority is warranted.

EXPLANATION OF PROVISION

The provision extends the authority for the demonstration project and the concomitant disclosure authority of the IRS through December 31, 2002. The statutory waiver of the redisclosure restrictions, safeguards, and criminal penalty provisions continue to apply. Further, the items authorized for disclosure continue to be limited to the name, address, taxpayer identification number, and signature of the taxpayer.

EFFECTIVE DATE

The provision is effective on the date of enactment.

VI. EXTENSION OF CERTAIN TRADE PROVISIONS EXPIRING IN 2001

A. GENERALIZED SYSTEM OF PREFERENCES

(Sec. 501 of the bill)

PRESENT LAW

Title V of the Trade Act of 1974 established the Generalized System of Preferences, whereby the President may provide duty-free treatment to imports of eligible articles from developing countries and territories, subject to certain conditions and limitations. The Generalized System of Preferences expired on September 30, 2001.

[61] Sec. 6103(d)(5). The following restrictions and requirements do not apply: (1) the prohibition on disclosure of returns or return information by State officers and employees (sec. 6103(a)(2)); (2) the Federal penalties for unauthorized disclosure and inspection of returns and return information (secs. 7213 and 7213A) and (3) the requirement that the State establish safeguards regarding the information obtained from the IRS (sec. 6103(p)(4)).

The purpose of the Generalized System of Preferences is to promote three broad policy goals: (1) to foster economic development in developing countries through increased trade; (2) to promote U.S. trade interests by encouraging beneficiary countries to open their markets and comply more fully with international trading rules; and (3) to help maintain U.S. international competitiveness by lowering costs for U.S. businesses, as well as lowering prices for American consumers.

To qualify for the Generalized System of Preferences, each beneficiary country is subject to various mandatory and discretionary eligibility criteria. Product categories are also subject to eligibility criteria. Several articles are statutorily exempt from preferential treatment, including certain textile and apparel articles, watches, and other import-sensitive products. The Generalized System of Preferences currently provides duty-free treatment to about 6200 articles from approximately 140 beneficiary developing countries and territories.

Section 114 of the African Growth and Opportunity Act (P.L. 106–200), enacted on May 18, 2000, extended the Generalized System of Preferences benefits through September 30, 2008 to eligible products from qualifying sub-Saharan African countries.

REASONS FOR CHANGE

The Committee believes that the Generalized System of Preferences has been highly effective in fostering development through trade, promoting U.S. trade interests by encouraging beneficiary countries to open their markets and comply with international trade rules, and maintaining U.S. competitiveness by lowering costs for U.S. businesses and lowering prices for U.S. consumers.

EXPLANATION OF PROVISION

The provision renews the Generalized System of Preferences for the period from October 1, 2001, through December 31, 2002. The provision is retroactive for items imported after September 30 that would have qualified for coverage if the Generalized System of Preferences had not expired. Imports made after September 30, 2001, and before the date of enactment are eligible for duty-free treatment, and refunds of any duty paid.

EFFECTIVE DATE

The provision is effective on October 1, 2001.

B. Andean Trade Preference Initiative

(Sec. 502 of the bill)

PRESENT LAW

The Andean Trade Preference Act provides preferential, mostly duty-free, treatment of selected U.S. imports from Bolivia, Ecuador, Columbia, and Peru. The Act authorizes the President to proclaim duty-free treatment for eligible articles from a beneficiary country, in accordance with the requirements of the Act. The Andean Trade Preference Act was originally introduced in 1991 as part of an initiative to address the growing narcotics trade problem in Latin

America by promoting viable alternatives to illicit drug production. By reducing or eliminating tariffs on eligible imports, the Andean Trade Preference Act provides an incentive for redirecting resources used for drug-related activities to Andean Trade Preference Act-eligible products. The Andean Trade Preference Act expires December 4, 2001.

Several conditions and requirements must be satisfied for imports to be eligible for preferential treatment under the Andean Trade Preference Act. Each of the four eligible nations must be designated by the President a "beneficiary country," based on statutory criteria. Beneficiary status can be denied to a country for several reasons. Beneficiary status can be denied if the country is a Communist country, if it unfairly nationalizes or expropriates U.S. property, if it fails to act in good faith in recognizing or enforcing arbitral awards, and for several other reasons. The President is also required to consider other enumerated factors in determining beneficiary country status, such as economic conditions and compliance with trade agreements. The President is authorized to withdraw or suspend a designation if appropriate because of changed circumstances.

Additionally, to obtain duty-free status, eligible articles must be imported directly from a beneficiary country. Many products are ineligible for duty-free treatment under the Andean Trade Preference Act, such as textile and apparel products, while certain products are only eligible for a reduction in duties. Other specific requirements exist for articles to qualify for duty-free treatment. The cost or value of materials originating in beneficiary countries (under the Andean Trade Preference Act or under the Caribbean Basin Economic Recovery Act), Puerto Rico and the Virgin Islands, plus costs of producing done in those countries generally must equal at least 35 percent of the value of the article when it enters the United States. However, up to 15 percent of that portion may be attributable to U.S. inputs. The major imports entering the United States under the Andean Trade Preference Act include cut flowers, copper cathodes, precious metals, pigments, non-canned tuna, and zinc.

The Andean Trade Preference Act operates in addition to the Generalized System of Preferences. Goods eligible for both must enter the U.S. under one or the other, at the importer's discretion. Unlike the Generalized System of Preferences, benefits under the Andean Trade Preference Act generally are not subject to caps on import volumes for particular products.

REASONS FOR CHANGE

The Committee believes that the Andean Trade Preference Act has had a positive impact on United States trade with Bolivia, Colombia, Ecuador, and Peru, resulting in increased jobs and expanded export opportunities in both the United States and the Andean region. Additionally, the Andean Trade Preference Act has been a key element in the United States counter-narcotics strategy in the Andean region.

EXPLANATION OF PROVISION

The provision extends the trade benefits available under the Andean Trade Preference Act through June 4, 2002.

EFFECTIVE DATE

The provision is effective on December 5, 2001.

C. Trade Adjustment Assistance Program

(Sec. 503 of the bill)

PRESENT LAW

The trade adjustment assistance programs were enacted in their current forms in the Trade Act of 1974. Congress has renewed the programs since then. The current authorization expired on September 30, 2001, and has been extended in a Continuing Resolution through November 15, 2001. The three trade adjustment assistance programs are: (1) trade adjustment assistance for workers, (2) trade adjustment assistance for firms, and (3) the North American Free Trade Agreement transitional adjustment assistance. The worker programs provide direct assistance and training to workers who are laid off in trade-impacted industries. The trade adjustment assistance for firms program provides technical assistance to small and medium-sized businesses that experience layoffs due to import competition. The main beneficiaries of the programs are apparel/textile, oil and gas, electronics, and the metal/machinery industries.

Section 245 of the Trade Act of 1974, as amended (19 U.S.C. 2317), authorizes appropriations to the Department of Labor for the period beginning October 1, 1999 through September 30, 2001, of such sums as may be necessary to administer the general trade adjustment assistance and North American Free Trade Agreement-related transitional adjustment assistance programs of Chapter 2 of Title II of that Act. Section 256 of the Trade Act of 1974, as amended (19 U.S.C. 2346(b)), authorizes appropriations to the Department of Commerce for the period beginning October 1, 1999 through September 30, 2001, of such sums as may be necessary to administer the trade adjustment assistance for firms program (Chapter 3 of Title II of the Trade Act of 1974, as amended).

REASONS FOR CHANGE

The Committee believes that the trade adjustment assistance programs provide valuable benefits for workers and firms and should be continued.

EXPLANATION OF PROVISION

The provision extends the authorization of the trade adjustment assistance programs through December 31, 2002.

EFFECTIVE DATE

The provision is effective on the date of the enactment.

VII. HEALTH INSURANCE COVERAGE OF WORKERS

A. COBRA Coverage for Displaced Workers

(Sec. 601 of the bill)

PRESENT LAW

The Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") requires an employer with 20 or more employees to offer the option of continued health insurance coverage at group rates to qualified employees and their families who are faced with loss of coverage due to certain events (e.g., termination, reduction of hours, retirement, death of an insured spouse). The coverage generally lasts for 18 months, but can last up to 36 months, depending on the nature of the qualifying event. The employer is not required to pay for this coverage; rather, the beneficiary can be required to pay up to 102 percent of the applicble premium. Employers who fail to provide the continued health insurance option are subject to tax and other penalties.

COBRA applies to employers who purchase group health plans for their employees, as well as those who self-insure. An employer must comply with COBRA even if it does not contribute to the health plan, as long as the employer maintains such a plan.

The average annual cost of COBRA premiums is $2,650 for an individual and $7,053 for a family ($220 and $590 per month, respectively). As a result, only 14 to 18 percent of COBRA-eligible workers take up this option.

REASONS FOR CHANGE

The Committee recognizes that the high cost of COBRA coverage makes it unaffordable for many individuals and families. A 75 percent COBRA premium subsidy will help up to 7 million Americans maintain their private group health insurance.

EXPLANATION OF PROVISION

The bill provides a temporary 75 percent premium subsidy for COBRA coverage for displaced workers who lose their jobs after September 11, 2001. The subsidy is available for up to 12 months. All benefits end no later than December 31, 2002 regardless of how long an individual has received such coverage.

The Secretary of Treasury, in consultation with the Secretary of Labor, is to administer the program through appropriate direct payment arrangements with group health plans, employers, and/or state unemployment insurance offices. States have the option to administer this program, provided that they notify the Secretary and develop a plan for making the subsidies available by January 1, 2002.

The Committee expects that the new program can be implemented quickly and efficiently, and the bill specifies that the provisions must be implemented without regard to whether final regulations have been promulgated. Employers must notify newly separated workers and those who became separated between September 11, 2001, and the date of enactment informing them of availability of the COBRA premium subsidy. Development of model notices and enrollment forms are the responsibility of the Department of Labor. The Department of the Treasury is responsible for advising employers of the new program and furnishing the appropriate notices and forms that have been developed for this program.

Once enrollment forms have been filed with an employer or its designee, an eligible displaced worker is considered to be enrolled in the subsidy program and is responsible only for the portion of the COBRA premium that is not subsidized.

EFFECTIVE DATE

The program expires on December 31, 2002, and no coverage is available after this date.

B. MEDICAID COVERAGE FOR DISPLACED WORKERS

(Secs. 602 and 603 of the bill)

PRESENT LAW

Medicaid is a means-tested health care entitlement program financed by both states and the federal government. The program was created to assist low-income Americans, but coverage is dependent upon several other criteria in addition to income. Eligibility is generally limited to those persons falling into particular categories, such as low-income children, pregnant women, the elderly, people with disabilities, and parents meeting specific income thresholds.

By law, the federal government matches at least 50 percent of the cost of Medicaid in each state, and can match as much as 83 percent, depending on a state's per capita income. On average, the federal government pays 57 percent of the cost of Medicaid in each state, with relatively poor states receiving a higher matching rate than relatively wealthy states.

States receive a higher federal matching rate for expenditures made under the Children's Health Insurance Program ("CHIP"). Through the CHIP "enhanced matching rate," the federal government pays a minimum of 65 percent of the cost of state CHIP programs, and a maximum of 85 percent of the cost. The average federal matching rate paid to states is 70 percent.

States have considerable flexibility in structuring their programs within broad federal guidelines governing eligibility, provider payment levels and benefits. As a result, Medicaid programs vary widely from state to state.

REASONS FOR CHANGE

The Committee recognizes that many displaced workers are not eligible for COBRA coverage. Such workers include those who worked for small businesses and for firms that go bankrupt or drop health coverage for their remaining employees. The Congressional Budget Office ("CBO") estimates that of the 18 million workers expected to lose their jobs and health insurance during the period this program would be in effect, only half are eligible for COBRA.

A state option to cover such workers under Medicaid would provide affordable coverage for nearly two million displaced workers who otherwise would be uninsured. Building on a well-established health care program that operates in every state ensures that states would be able to enroll new eligibles quickly and efficiently. The enhanced matching rate, which averages 70 percent, and the flexibility to set income and resource eligibility standards, will further encourage states to utilize this option.

A state option to subsidize the remainder of the COBRA premium (i.e.,"wrap-around" premium assistance) for low-income workers would help more Americans maintain their health insurance and allow for other consumer spending by low-income households, further spurring economic recovery.

EXPLANATION OF PROVISION

The bill creates a temporary state option to provide Medicaid coverage to workers who were laid off after September 11, 2001, and who are not eligible for COBRA. Coverage would be available for 12 months. All benefits would end no later than December 31, 2002, regardless of how long an individual has received such coverage.

States adopting this option would receive the CHIP enhanced matching rate and are permitted to use the same eligibility criteria allowed through the "Ticket to Work and Work Incentives Act of 1999"[62] (i.e., full subsidies up to 250 percent of the federal poverty level and sliding-scale assistance up to 450 percent of poverty).

The bill also creates a temporary state option to subsidize the remainder of the premium for low-income Americans eligible for the 75 percent COBRA premium subsidy. States adopting this option could provide such coverage for individuals up to 200 percent of the federal poverty level.

EFFECTIVE DATE

The program expires on December 31, 2002, and no coverage is available after this date, regardless of how long an individual has received such coverage.

C. TEMPORARY INCREASE IN FEDERAL MEDICAID MATCHING RATE

(Sec. 604 of the bill)

PRESENT LAW

The federal government matches at least 50 percent of the cost of Medicaid in each state and can match as much as 83 percent depending on a state's per capita income. On average, the federal government pays 57 percent of the cost of Medicaid in each state, with relatively poor states receiving a higher matching rate than relatively wealthy states.

The Federal Medical Assistance Percentage ("FMAP") for each state is based on the state's per capita income relative to the national average and is determined by census data from the most recently available three calendar years. Because the Medicaid matching rates for FY 2002 are based on state per capita income data for the years 1997, 1998, and 1999, changes in states' matching rates for 2002 were triggered by changes in their economies that

[62] Pub. L. No. 106–170.

occurred during those years. More recent economic trends are not reflected in the new matching rates.

REASONS FOR CHANGE

Because the economy was especially strong between 1997 and 1999, the FY 2002 federal Medicaid matching rates are reduced for 29 states. Rates in three states will be reduced by more than two percentage points.

Beyond the FY 2002 decrease that more than half of all states will experience, the Committee also recognizes that the number of Americans who qualify for Medicaid is expected to increase substantially as a result of the economic downturn. A recent report estimates that a 2 percent increase in unemployment will result in an additional 3.2 million Medicaid eligibles, assuming current eligibility levels are maintained. Based on these assumptions, the Committee expects that the 0.5 percent increase in the unemployment rate in the last month resulted in 800,000 new Medicaid eligibles.

At the same time that Medicaid rolls are increasing, state funding is expected to decrease. A report by the National Conference of State Legislatures on state fiscal outlooks for 2002 asserts that Medicaid is the "biggest culprit" driving increases in state spending. Increasing eligibility for Medicaid benefits, coupled with lower-than-anticipated revenues, and decreased federal matching rates is likely to result in state budget cuts for the Medicaid program. Increasing the federal Medicaid matching rate will give states additional funds to support the growing Medicaid rolls and avoid budget cuts to the program.

EXPLANATION OF PROVISION

The bill provides temporary financial assistance to states to help them meet the temporary rise in Medicaid costs that will result from the recent economic downturn. First, states in which the federal Medicaid matching rate is falling in FY 2002 would be "held harmless" and retain their FY 2001 matching rate. States in which the rates are equal to the FY 2001 rate or rising would receive the FY 2002 rate. Second, all states would receive a federal Medicaid matching rate increase of 1.5 percent. Third, states with higher than the national average unemployment rate over the previous three months, determined on a quarterly basis, would receive an additional 1.5 percent increase—bringing their total matching rate increase to 3.0 percent. In exchange for these increases, states must maintain current eligibility levels.

EFFECTIVE DATE

Changes made by this provision are effective for FY 2002 only.

VIII. UNEMPLOYMENT INSURANCE

A. Extended Benefits

(Secs. 701–708 of the bill)

PRESENT LAW

States set unemployment benefit rules within a broad federal framework. The maximum length of benefits is 26 weeks in all but two states. The average duration on unemployment was 14.5 weeks in 1999. During FY 1999, 32 percent of recipients used all of their eligibility, or "exhausted eligibility."

Extended benefits for an additional 13 weeks are available in states suffering severe economic distress. These benefits become available when a state's "insured" unemployment rate is 5 percent and 120 percent of the average over the last two years or, at state option, if the "insured" rate is 6 percent. (The insured unemployment rate reflects only job losers covered by unemployment insurance and is 2 to 3 percent lower than the more familiar "total unemployment rate.") A handful of states have adopted a third trigger, a total unemployment rate of 6.5 percent and 110 percent of the average over the past two years. The benefits are 50 percent federally-funded. (Regular unemployment insurance (UI) benefits are funded by state taxes levied on employers.)

Congress has occasionally provided extended benefits on a Federally funded basis. Since 1970, Congress has acted four times—in 1971, 1974, 1982, and 1991—to establish temporary programs of supplemental assistance.

REASONS FOR CHANGE

The triggers for the extended benefit program are outdated and are set too high for the current economic conditions. During the recession of the early 1990s only 10 states ever hit the necessary triggers despite widespread distress. In addition, from a fiscal stimulus perspective, requiring states to finance 50 percent of additional benefits is less efficient than 100 percent federal funding since states are already under fiscal strain.

EXPLANATION OF PROVISION

The bill provides, through cooperative agreements with the states, 13 weeks of extended benefits in all states, starting immediately. The benefits are available to those who have "exhausted" regular UI eligibility first and are still unable to locate work. Eligibility for extended benefits includes those who exhaust unemployment benefits after September 11, 2001, as well as those who initially lose their job after September 11, 2001. The benefits are available until December 31, 2002, and are 100 percent Federally-funded.

EFFECTIVE DATE

The 13 weeks of federally-funded extended benefits expires on December 31, 2002.

B. Part-Time Workers

PRESENT LAW

In general, states establish rules to determine whether an unemployment applicant is "available for work" and willing to accept "suitable employment." A general program rule also requires those receiving unemployment compensation to seek work that is "comparable" to previous employment. Thirty-one states require that those receiving unemployment compensation pursue full-time employment as part of being "available for work" and willing to accept "suitable employment."

Employers must pay unemployment taxes on behalf of those working on a part-time basis. Further, those working part-time often meet other eligibility criteria for receiving unemployment compensation (e.g., minimum earnings tests). Despite these factors, however, most states require part-time workers to seek full-time work as a condition of receiving unemployment benefits.

Nationwide, nearly 20 percent of workers are employed part-time. Some work part-time because they are unable to find full-time work. These individuals are usually eligible for unemployment benefits because they are willing to work full-time. But others are only able to work part-time due to family obligations or other reasons (e.g., former welfare recipients just entering the workforce). An estimated 300,000 former part-time workers per year are ineligible for unemployment benefits because of the full-time requirement.

REASONS FOR CHANGE

The Committee recognizes that part-time work is a regular and accepted feature of the economy. In the service sector, part-time employment is common. Permitting certain individuals seeking part-time work to receive unemployment compensation makes sense on equity grounds, as taxes were paid on their behalf as workers. It also makes sense in the context of economic stimulus because the unemployed are likely to spend any benefits they receive.

EXPLANATION OF PROVISION

The bill makes certain individuals seeking part-time work eligible for unemployment benefits. Specifically, former part-time workers are eligible for benefits if they are seeking comparable employment. Former full-time workers may be eligible for benefits, but only if they are able to demonstrate good cause for seeking or only being available for part-time work.

The benefits for these individuals is federally-funded and available until December 31, 2002. State rules concerning minimum earnings requirements and other eligibility criteria still apply. States that already provide unemployment benefits to those seeking part-time work would receive federal funding.

EFFECTIVE DATE

Federal funding of benefits for part-time workers expires on December 31, 2002.

C. Alternative Base Period

PRESENT LAW

Eligibility for unemployment benefits is generally determined based on earnings over a year, known as the "base period." States have a variety of tests, such as minimum earnings levels and/or quarters worked, to determine whether an applicant has sufficient work history to qualify. Thirty-eight states currently use the first four of the most recently completed five quarters as the relevant base period. For applicants in these states, the most recent wage data used for eligibility determination is four to six months old.

REASONS FOR CHANGE

The General Accounting Office recently reported that excluding the most recent wage data disproportionately hurts low-wage workers. It can also be a problem for former welfare recipients who might work for six to nine months after leaving the rolls and then find, after losing a job, that much of that time does not count toward eligibility for unemployment benefits, leaving them to turn back to welfare for assistance. An estimated 300,000 applicants per year would receive unemployment benefits if their most recent earnings are used for eligibility determination.

Determining eligibility for unemployment benefits based on the most recent earnings data is a matter of equity, as taxes are paid on behalf of these workers. It is also a matter of sound economic stimulus policy, since these displaced workers are likely to spend any income they receive quickly. This change would be particularly beneficial to states with seasonal workers. It could also provide fiscal relief to states by providing unemployment benefits to former welfare recipients who become unemployed and would otherwise have to seek welfare again.

EXPLANATION OF PROVISION

The bill requires states to redetermine eligibility for unemployment benefits using the most recently completed quarter of earnings data if the data has been reported to the state. If an applicant's "alternative base period" wage history would make the applicant eligible then benefits would be provided, according to the normal state formulas. The benefits would be federally-funded and would be available until December 31, 2002.

EFFECTIVE DATE

Federal funding of benefits for those determined to be eligible based on the most recent quarter of earnings data would expire on December 31, 2002.

D. Supplemental Benefits

PRESENT LAW

States determine unemployment benefit levels. Typically, these levels are established to replace 50 percent of recipients' former wages, up to a maximum. Those with higher earnings as workers generally receive higher benefits. The national weekly average is

$231, and average wage replacement is 47 percent. This amount represents an income that is two-thirds of the federal poverty level for a family of four in 2001.

REASONS FOR CHANGE

The Committee recognizes that unemployment benefit levels are low, in real terms. Given these low levels, and the hardship associated with unemployment, the Committee believes that any additional benefits will be quickly spent, thereby spurring economic recovery.

EXPLANATION OF PROVISION

The bill provides a temporary federal supplement to unemployment benefits of 15 percent or $25 per week, whichever is higher. For the average unemployed recipient this represents an additional $35 per week. The supplement is applied to benefits provided under the extended benefit, part-time worker, and "alternative base period" provisions of the bill in addition to the 26 weeks of regular benefits.

EFFECTIVE DATE

Federal funding of additional benefits expires on December 31, 2002.

E. Administrative Funding

PRESENT LAW

Unemployment insurance programs are operated by the states but funded by the federal government. A portion of the federal unemployment tax is reserved in a trust fund, and the Labor-HHS appropriations bill annually appropriates a portion of those funds, on the basis of a workload-based calculation, to support state administration efforts. There is also a contingency reserve, which allows states to receive additional appropriated funding when unemployment claims rise substantially.

Under the Reed Act, when reserves in the three federal unemployment trust fund accounts exceed statutory limits, funds are transferred to state unemployment program accounts. The Balanced Budget Act of 1997 limited such transfers to $100 million in FY 2002.

REASONS FOR CHANGE

The bill provides unemployment benefits to two categories of applicants who are currently ineligible in many states. These changes will require updating of systems in some cases and, perhaps, additional staff. Additional resources for administration will facilitate implementation of the bill.

EXPLANATION OF PROVISION

The bill provides an additional $500 million accelerated "Reed Act" distribution of funds from the federal UI accounts to states.

EFFECTIVE DATE

The distribution of these funds applies in FY 2002 only.

F. FINANCING

PRESENT LAW

Regular unemployment benefits are financed by states through taxes levied on employers. These taxes are usually "experience-rated" so that employers with more former employees receiving unemployment benefits pay higher tax rates. The taxes are payroll taxes in the form of a percentage of wages up to certain maximum wage level. In 1999 the average tax rate was 1.8 percent of taxable wages. Tax rates can vary from zero on some employers to as high as 10 percent in two states.

The federal unemployment tax, known as FUTA, is 0.8 percent on the first $7,000 of wages. These funds are deposited into three federal unemployment accounts. The first, the Employment Security Administration Account, supports state program administration. The second, the Extended Unemployment Compensation Account, provides the funds for the 50 percent share of the extended benefits program. The third, Federal Unemployment Account, provides funds for loans to state unemployment programs in distress to ensure a continued flow of benefits.

As noted, the Reed Act requires that funds exceeding a statutory ceiling be transferred to state unemployment trust funds. The CBO baseline for the Budget Resolution projected transfers to state programs of between $3 to $4 billion per year beginning in FY 2003.

EXPLANATION OF PROVISION

The bill uses funds in the federal accounts to pay for the benefits. Because of the CBO projections of Reed Act distributions, the 10 year cost of the bill is less than $1 billion—the bill is paid for by accelerating spending due to occur over the next 10 years.

EFFECTIVE DATE

Acceleration of Reed Act distributions begins in FY 2002 and continues over ten years.

IX. EMERGENCY AGRICULTURE ASSISTANCE

A. INCOME ASSISTANCE FOR AGRICULTURAL PRODUCERS

(Secs. 801–823 of the bill)

PRESENT LAW

Congress has periodically established a temporary program in order to provide assistance to farmers who suffer income losses due to damaging weather or related conditions (including losses due to crop diseases and insects). The most recent program was authorized under section 815 of the Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001. This section provides that the Secretary shall make assistance available in the same manner as provided under section 1102 of the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 1999, including using the same eligibility thresholds that were used in administering that section.

REASONS FOR CHANGE

The previous program expired at the end of fiscal 2001.

EXPLANATION OF PROVISION

This section provides $1.8 billion of funds of the Commodity Credit Corporation for an income assistance program on terms identical to those contained in the fiscal 2001 law. It authorizes the Secretary to make assistance available, pro rata, to compensate for income losses resulting from damaging weather or related conditions in calendar 2001.

EFFECTIVE DATE

The provision is effective upon passage of this bill into law.

B. Livestock Disaster Assistance

PRESENT LAW

Congress has periodically established a temporary program in order to provide direct payments to livestock producers who suffer grazing losses due to adverse weather or natural disasters. The most recent program was authorized under section 806 of the Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001. This section provides that the Secretary shall make and administer payments for livestock losses using the criteria established to carry out the 1999 Livestock Assistance Program.

REASONS FOR CHANGE

The Livestock Assistance Program expired at the end of fiscal 2001.

EXPLANATION OF PROVISION

This section provides $500 million of funds of the Commodity Credit Corporation for the Livestock Assistance Program, on terms identical to those contained in the fiscal 2001 law.

It authorizes the Secretary to make payments to eligible livestock producers in counties that have received an emergency designation by the President or the Secretary after January 1, 2001.

It provides further that the Secretary shall use not more than $12 million to carry out the American Indian Livestock Feed Program.

EFFECTIVE DATE

The provision is effective upon passage of this bill into law.

C. Commodity Purchases

PRESENT LAW

Congress has periodically established a temporary agricultural commodity purchase program to assist producers, including producers of specialty crops, who have suffered losses due to low prices.

REASONS FOR CHANGE

Market conditions, especially those affecting specialty crops, warrant extension of the commodity purchase program.

EXPLANATION OF PROVISION

This section provides $220 million of funds of the Commodity Credit Corporation to purchase agricultural commodities, especially agricultural commodities that have experienced low prices during the 2001 crop year, as determined by the Secretary. The Secretary is encouraged to purchase agricultural commodities under this section in a manner that reflects geographic diversity of agricultural production in the United States, particularly agricultural production in the Northeast and Mid-Atlantic States. Further, it directs that not less than $55 million of the funds shall be used to purchase agricultural commodities of the type distributed under section 6(a) of the Richard B. Russell national School Lunch Act.

EFFECTIVE DATE

This provision is effective upon passage of this bill into law.

D. Rural Community Advancement Program

PRESENT LAW

Under section 306(a) of the Consolidated Farm and Rural Development Act, the Secretary may provide direct loans and grants for the costs of water and waste disposal. This Act also permits the Secretary to provide direct loans and loan guarantees for community facilities.

REASONS FOR CHANGE

This provision will support over $1 billion in grants and nearly $1.9 billion in direct loans to establish, expand or modernize water treatment and waste disposal facilities. These systems generally serve rural communities of 10,000 or less population that cannot obtain credit elsewhere. The backlog of these applications for these funds greatly exceeds funding otherwise available. Funds will also support over $340 million in loans and grants to construct and improve essential community facilities, including health care, child care, fire and emergency services and other facilities. Acceleration of funding for these facilities will stimulate job growth and other economic activity in rural areas, in addition to meeting critical water supply and waste disposal needs.

EXPLANATION OF PROVISION

This section appropriates $1.273 billion in funding to support additional loans and grants under the Rural Community Advancement Program. These funds include $130,100,000 for the cost of water or waste disposal direct loans; $1,074,798,000 for water or waste disposal grants; $8,362,000 for the cost of community facility direct loans; and $60,000,000 for community facility grants. The Secretary may also guarantee an additional $128,000 for community facility guaranteed loans.

EFFECTIVE DATE

This provision is effective upon passage of this bill into law.

E. Rural Telecommunications Loans

PRESENT LAW

Under sections 305 and 306 of the Rural Electrification Act of 1936, the Secretary may make insured cost of money rural telecommunications loans.

REASONS FOR CHANGE

This provision provides funding for the significant backlog in program funding requests.

EXPLANATION OF PROVISION

The section appropriates $40 million for the significant backlog in FY2001 program funding. This additional funding will support $1.74 billion in loans to improve the telecommunications infrastructure in rural America, so that rural citizens and businesses can access the same type of high quality telecommunications services available elsewhere in America.

EFFECTIVE DATE

This provision is effective upon passage of this bill into law.

F. Distance Learning/Telemedicine/Broadband Loans

PRESENT LAW

The Food, Agriculture, Conservation and Trade Act of 1990 (chapter 1 of subtitle D of title XXIII) permits the Secretary to make additional loans and grants for the broadband pilot program and for telemedicine and distance learning services.

REASONS FOR CHANGE

This provision provides funding for the significant backlog in program funding requests.

EXPLANATION OF PROVISION

This section appropriates $5 million in funding to support an additional $400 million in loans to finance installation of enhanced services, such as high speed modems, Internet access to rural communities and advanced telecommunications that provide educational and health care benefits to rural Americans.

EFFECTIVE DATE

This provision is effective upon passage of this bill into law.

G. ENVIRONMENTAL QUALITY INCENTIVES PROGRAM (EQIP)

PRESENT LAW

The Environmental Quality Incentives Program was established under chapter 4 of subtitle D or title XII of the Food Security Act of 1985.

REASONS FOR CHANGE

This provision provides funding for the significant backlog in program funding requests.

EXPLANATION OF PROVISION

This section provides $1.4 billion of funds of the Commodity Credit Corporation to carry out the environmental quality incentives program backlog.

EFFECTIVE DATE

This provision is effective upon passage of this bill into law.

H. FARMLAND PROTECTION PROGRAM

PRESENT LAW

The Farmland Protection Program was established under section 388 of the Federal Agriculture Improvement and Reform Act of 1996.

REASONS FOR CHANGE

This provision provides funding for the significant backlog in program funding requests. Funds will support acquisition of conservation easements or other interest in order to limit the conversion of agricultural lands to nonagricultural uses. Benefits include protection of prime, unique, or other productive soil and preservation of open spaces.

EXPLANATION OF PROVISION

This section provides $150 million of funds of the Commodity Credit Corporation to carry out the farmland protection program backlog.

EFFECTIVE DATE

This provision is effective upon passage of this bill into law.

I. Administration

PRESENT LAW

Congress has periodically authorized additional funding for salaries and expenses in order to carry out the provisions of emergency assistance legislation.

REASONS FOR CHANGE

Congress has periodically established temporary programs to provide income assistance for producers suffering from adverse weather conditions. This imposes additional workloads and expenses upon the agencies responsible for administering these programs.

EXPLANATION OF PROVISION

This provision provides to the U.S. Department of Agriculture $104,500,000 for salaries and expenses to carry out the provisions of this title.

EFFECTIVE DATE

The provision is effective upon passage of this bill into law.

X. ADDITIONAL PROVISIONS

A. Tax-Credit Bonds for the National Railroad Passenger Corporation ("Amtrak")

(Sec. 901 of the bill and new Sec. 54 of the Code)

PRESENT LAW

Present law does not authorize the issuance by any private, for-profit corporation of bonds the interest on which is tax-exempt or eligible for an income tax credit. Tax-exempt bonds may be issued by States or local governments to finance their governmental activities or to finance certain capital expenditures of private businesses or loans to individuals. Additionally, States or local governments may issue tax-credit bonds to finance the operation of "qualified zone academies."

Tax-exempt bonds

Interest on bonds issued by States or local governments to finance direct activities of those governmental units is excluded from tax (sec. 103). In addition, interest on certain bonds ("private activity bonds") issued by States or local governments acting as conduits to provide financing for private businesses or individuals is excluded from income if the purpose of the borrowing is specifically approved in the Code (sec. 141). Examples of approved private activities for which States or local governments may provide tax-exempt financing include transportation facilities (airports, ports, mass commuting facilities, and certain high speed intercity rail facilities); public works facilities such as water, sewer, and solid waste disposal; and certain social welfare programs such as low-income rental housing, student loans, and mortgage loans to certain first-time homebuyers. High speed intercity rail facilities eligible for tax-exempt financing include land, rail, and stations (but not rolling stock) for fixed guideway rail transportation of passengers and their baggage using vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled stops.

Issuance of most private activity bonds is subject to annual State volume limits of $62.50 per resident ($187.5 million if greater). These volume limits are scheduled to increase to $75 per resident ($225 million if greater) in calendar year 2002; after 2002, the limits will be indexed annually for inflation.

Investment earnings on all tax-exempt bonds, including earnings on invested sinking funds associated with such bonds is restricted by the Code to prevent the issuance of bonds earlier or in a greater amount than necessary for the purpose of the borrowing. In general, all profits on investment of such proceeds must be rebated to the Federal Government. Interest on bonds associated with invested sinking funds is taxable.

Tax-credit bonds for qualified zone academies

As an alternative to traditional tax-exempt bonds, certain States or local governments are given authority to issue "qualified zone academy bonds." A total of $400 million of qualified zone academy bonds is authorized to be issued in each year of 1998 through 2001. The $400 million is allocated to States according to their respective populations of individuals below the poverty line.

Qualified zone academy bonds are taxable bonds with respect to which the investor receives an income tax credit equal to an assumed interest rate set by the Treasury Department to allow issuance of the bonds without discount and without interest cost to the issuer. The bonds may be used for renovating, providing equipment to, developing course materials for, or training teachers in eligible schools. Eligible schools are elementary and secondary schools with respect to which private entities make contributions equaling at least 10 percent of the bond proceeds.

Only financial institutions are eligible to claim the credits on qualified zone academy bonds. The amount of the credit is taken into income. The credit may be claimed against both regular income tax and AMT liability.

There are no arbitrage restrictions applicable to investment earnings on qualified zone academy bond proceeds.

Tax treatment of certain contributions to the capital of a corporation

Section 118(a) provides that gross income of a corporation does not include a contribution to its capital. In general, section 118(b) provides that a contribution to the capital of a corporation does not include any contribution in aid of construction or any other contribution as a customer or potential customer and, as such, is includable in gross income of the corporation.

REASONS FOR CHANGE

The Committee believes that this grant of authority to issue tax credit bonds is an appropriate way to improve the nation's passenger rail systems. The Committee believes this provision is timely in light of the economic dislocation attendant in the U.S. transportation industry following the September 11, 2001, terrorist attacks.

EXPLANATION OF PROVISION

Tax-credit bond authority

The provision authorizes the National Railroad Passenger Corporation ("Amtrak") to issue an aggregate amount of $7 billion of tax-credit bonds to finance its capital projects during calendar year 2002. In addition to this $7 billion for capital expenditures generally, $2 billion of tax-credit bonds may be issued to finance construction of a new Hudson River rail tunnel. Unused bond authority may be carried forward for up to two years under rules similar to those that apply to carryforward of authority to issue qualified zone academy bonds.

Projects eligible for tax-credit bond financing are defined as the acquisition or construction of equipment or rolling stock, and other capital improvements for (1) the northeast rail corridor between Washington, D.C. and Boston, Massachusetts; (2) high-speed rail corridors designated under section 104(d)(2) of Title 23 of the United States Code; and (3) non-designated high-speed rail corridors, including station rehabilitation or construction, track or signal improvements, or grade crossing elimination. Limits are imposed on the portion of the $7 billion in bond authority that could be issued to finance projects in any one State or on any one rail corridor. Additionally, 15 percent of that amount would be required to be set-aside for use in non-Federally designated high speed rail corridors.

The maximum maturity of Amtrak tax-credit bonds is 20 years. Proceeds from the sale of the bonds must be deposited in a specially trust account, where those amounts will be invested until spent for the purpose of the borrowing. Investment earnings on the bond proceeds and on required matching contributions from States (see below) where the bond-financed improvements will be located also are retained in the trust account. Those latter amounts can be used only for repayment of outstanding bonds, and for other qualified projects once all outstanding tax-credit bonds are repaid.

As with qualified zone academy bonds, the interest rate on Amtrak tax-credit bonds is set to allow issuance of the bonds at par, i.e., without any interest cost to Amtrak. In general, proceeds of Amtrak tax-credit bonds must be spent within 36 months after the bonds are issued. As of the date the bonds are issued, Amtrak is required to certify that it reasonably expects—

(1) to incur a binding obligation with a third party to spend at least 10 percent of the bond proceeds within six months (or in the case of self-constructed property, to have commenced construction within six months);

(2) to spend the bond proceeds with due diligence; and

(3) to spend at least 95 percent of the proceeds for qualifying capital costs within three years.

Failure to satisfy these requirements triggers special rules at the conclusion of the three-year period.

Amtrak tax credit bonds may only be issued for projects that are approved by the Department of Transportation and with respect to which the issuing railroad had received matching contributions of at least 20 percent of the project cost from one or more States in which the projects would be located. This approval is conditioned on, among other things, Amtrak agreeing to spend certain amounts of the bond proceeds for other passenger rail carriers (including the Alaska Railroad). The State matching contributions, along with earnings on investment of the tax-credit bond proceeds is required to be invested in a trust account (i.e., an sinking fund) and used along with earnings on the trust account for repayment of the principal amount of the bonds.

Amtrak tax-credit bonds may be owned (and income tax credits claimed) by any taxpayer. The amount of the credit is included in the bondholder's income.

The required State matching contribution cannot be derived from Federal monies. Any Federal Highway Trust Fund monies transferred to the States are treated as Federal monies for this purpose. During the period when tax-credit bonds were authorized, Amtrak is not allowed to receive any Highway Trust Fund monies other than those authorized (both amount and purpose) on the date of the provision's enactment. Violation of this restriction (including pursuant to subsequently enacted legislation) results in (1) termination of deposit to the Highway Trust Fund of all Federal highway excise tax revenues and (2) inability of Amtrak to issue additional tax-credit bonds (until such time as the Secretary of the Treasury and the Secretary of Transportation certified that Amtrak had repaid the amounts received from the Highway Trust Fund).

Amtrak is required annually to submit a five-year capital plan to Congress, and to satisfy independent oversight requirements with respect to the management of tax-credit-bond-financed projects. Finally, the Treasury Department is required to certify annually that funds deposited in the escrow accounts for repayment of tax-credit bonds (with actual and projected earnings thereon) are sufficient to ensure full repayment of the bond principal.

Tax treatment of improvements to property owned by freight railroads

The provision provides that any contribution by Amtrak of personal or real property funded by the proceeds of Amtrak tax-credit bonds is considered a contribution to the capital of a corporation. Thus, such contributions are not taxable to the recipient. Contributed property has a zero basis in the hands of the recipient.

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Broadband Internet Access Tax Credit

(Sec. 902 of the bill and new Code Sec. 48A)

PRESENT LAW

Present law does not provide a credit for investments in telecommunications infrastructure.

REASONS FOR CHANGE

The Committee seeks to increase the purchase, installation, and connection of equipment and facilities offering expanded broadband access to the Internet, particularly for potential subscribers in rural and low-income areas. The Committee believes that a temporary and focused tax credit will help the economy recover from the slowdown associated with the September 11th attacks. It would, first of all, stimulate the economy right away by encouraging providers to invest in high-speed telecom equipment. Such investment could not come at a better time, especially given the recent slowdown in the high-tech industry. Moreover, the tax credit's effects would not be limited to the high-tech industry. All companies use IT (information technology) and telecom technologies—broadband will make all businesses more efficient. (According to the Federal Reserve, information technology accounted for over 60 percent of the total productivity growth occurring from 1995 through 1999.) Small businesses, in particular, would benefit from deployment of broadband in rural and underserved areas.

The Committee also believes that the provision would address some of the most intractable problems associated with our country's transition to the digital economy—unequal availability of broadband access technologies. The Committee seeks to ensure that rural and underserved Americans can fully participate in an increasingly digital world.

EXPLANATION OF PROVISION

In general

The bill provides a 10 percent credit of the qualified expenditures incurred by the taxpayer with respect to qualified equipment with which the taxpayer offers "current generation" broadband services to potential subscribers in rural and underserved areas. In addition, the provision provides a 20 percent credit of the qualified expenditures incurred by the taxpayer with respect to qualified equipment with which the taxpayer offers "next generation" broadband services to potential business subscribers in rural and underserved areas, and to any potential residential subscriber. The credit is part of the general business credit and the taxpayer's basis in qualified equipment is reduced by any credit allowed.

Definition of "current generation broadband" and "next generation broadband"

Current generation broadband services is defined as the transmission of signals at a rate of at least one million bits per second to the subscriber and at a rate of at least 128,000 bits per second from the subscriber. Next generation broadband services is defined as the transmission of signals at a rate of at least 22 million bits per second to the subscriber and at a rate of at least five million bits per second from the subscriber.

Qualifying expenditures and equipment

Under the bill, qualified expenditures are those amounts otherwise chargeable to the capital account with respect to the purchase and installation of qualified equipment, the original use of which commences with the taxpayer, for which depreciation is allowable under section 168. Qualified expenditures are those that are incurred by the taxpayer after December 31, 2001, and before January 1, 2003. The expenditures are taken into account for purposes of claiming the credit in the first taxable year in which the taxpayer places the qualifying equipment in service.[63] The Committee is aware that the standard created in this provision is not the same as the "placed in service" standard generally applied in the Code in relation to investment credits or capital cost recovery. As such, the Committee intends that, in the case of property placed in service after December 31, 2002, the Secretary provide guidance to taxpayers regarding the accounting, reporting, and allocation of expenditures related to qualifying equipment that are incurred prior to January 1, 2003, when such qualifying equipment is placed in service after December 31, 2002. In the case of a taxpayer who incurs expenditures for equipment capable of serving both subscribers in qualifying areas and other areas, qualifying expenditures are determined by multiplying otherwise qualifying expenditures by the ratio of the number of potential qualifying subscribers to all potential subscribers the qualifying equipment would be capable of serving.[64]

Under the bill, not all equipment capable of providing current generation or next generation broadband service qualifies for the credit. Qualifying equipment must be capable of providing broadband services a majority of the time during periods of maximum demand to each subscriber who is utilizing such services and in a manner substantially the same as like services are provided by the service provider to subscribers utilizing equipment on which no credit is allowed. In addition, services provided utilizing otherwise qualifying equipment must be offered to potential subscribers at prices deemed comparable, under Treasury regulations, to similar services offered elsewhere by the service provider.

Additional restrictions apply to qualifying equipment depending upon the equipment's place in the architecture of the broadband system. In the case of a telecommunications provider, qualifying equipment is only that equipment that extends from the last point of switching to the outside of the building in which the subscriber is located. In the case of a commercial mobile service carrier, qualifying equipment is only that equipment that extends from the customer side of a mobile telephone switching office to a transmission/reception antenna (including the antenna) of the subscriber. In the case of a cable operator or open video system operator, qualifying equipment is only that equipment that extends from the customer side of the headend to the outside of the building in which the subscriber is located. In the case of a satellite carrier or other wireless carrier (other than a telecommunications carrier), qualifying equipment is only that equipment that extends from a transmission/re-

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[63] For this purpose property placed in service by a person and which is subsequently sold to the taxpayer and leased back by such person within three months of the date on which the property was originally placed in service is deemed to be placed in service by the taxpayer not earlier than the date on which such property is used under the leaseback.

[64] For this purpose residential subscribers are measured as the number of individuals and business subscribers are measured as the number of business entities (sole proprietorships, partnerships, S corporations, and C corporations) within the specified geographic area (generally census tracts).

ception antenna (including the antenna) to a transmission/reception antenna on the outside of the building used by the subscriber. Any packet switching equipment deployed in connection with other qualifying equipment is qualifying equipment, regardless of location, provided that it is the last such equipment in a series as part of transmission of a signal to a subscriber or the first in a series in the transmission of a signal from a subscriber. Multiplexing and demultiplexing equipment deployed in connection with other qualifying equipment is qualifying equipment only to the extent such equipment is uniquely designed to perform the function of multiplexing and demultiplexing packets or cells of data and making associated application adaptions, but only if such equipment is located between the last in the series of packet switches (as described above) and a building in which a subscriber is located.

Qualifying geographic areas

In general, qualifying expenditures are expenditures for qualifying equipment placed in service in rural or underserved areas in the case of the credit for current generation broadband investments. In the case of the credit for next generation broadband investments, expenditures for qualifying equipment to serve potential business subscribers in rural and underserved areas and potential residential subscribers, wherever located, qualify.[65]

Under the bill, a rural area is any census tract which is not within 10 miles of any incorporated or census designated place with a population of more than 25,000 and which is not within a county with a population density of more than 500 people per square mile. An underserved area is any census tract that is located in an empowerment zone, enterprise community, renewal zone, the District of Columbia enterprise zone, or any geographic area designated as a "low-income community" for purposes of the "new markets tax credit" (sec. 45D(e)). However, if under regulation the Secretary determines that certain rural and underserved areas are "saturated markets," taxpayers are not permitted to claim the credit for current generation broadband investments related to expenditures for otherwise qualifying equipment placed in service in such areas to serve residential subscribers. A saturated market is a census tract in which one or more service providers offer current generation broadband service to 85 percent or more of the potential residential subscribers within the census tract and that such service offered is available a majority of the time during periods of maximum demand to each subscriber who is utilizing such services and in a manner substantially the same as like services are provided by the service provider to subscribers utilizing equipment on which no credit is allowed.

Treasury regulations

The provision directs the Secretary to designate and publish within 90 days of the date of enactment all areas that qualify as "rural," "underserved," and "saturated markets." The provision directs the Secretary to prescribe regulations related to qualified ex-

[65] The Committee intends that Treasury regulations provide for the allocation of credit in the case of qualifying equipment providing next generation broadband services to home offices not located in rural areas and underserved areas.

penditures. The provision further provides that, until the Secretary prescribes regulations, taxpayers may make reasonable determination for purpose of claiming credit so long as the taxpayer's determination is consistent with maintaining competitive neutrality in the provision of broadband services and increasing the purchase, installation, and connection of equipment and facilities offering expanded broadband access to the Internet for potential subscribers in rural and low income areas and to all potential residential customers.

The provision also directs that no Federal or State agency or instrumentality shall adopt regulations or ratemaking proceedings that would have the effect of confiscating the credit or otherwise subverting the purpose of the proposal. While this directive is expected to ensure that the incentive to increase investment in broadband infrastructure operates to encourage such investments by inuring to the benefit of taxpayers making such investments, this directive is not intended to limit or otherwise affect the existing ability of appropriate regulators to limit public property rights or to impose rents or user fees in the ordinary course for the use of public property, or otherwise limit the ordinary scope of authority of such regulators.

EFFECTIVE DATE

The provision is effective for expenditures incurred after December 31, 2001.

C. EXPANSION OF PERIOD FOR REINVESTMENT OF CONVERTED CITRUS TREE PROPERTY AND RATABLE INCOME INCLUSION FOR CITRUS CANKER TREE PAYMENTS

(Sec. 903 of the bill and Sec. 1033 and new Sec. 1302 of the Code)

PRESENT LAW

Generally, a taxpayer recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

Under section 1033, gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the applicable period. The taxpayer's basis in the replacement property generally is the same as the taxpayer's basis in the converted property, decreased by the amount of any money or loss recognized on the conversion, and increased by the amount of any gain recognized on the conversion. The applicable period for the taxpayer to replace the converted property begins with the date of the disposition of the converted property (or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is earlier) and generally ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. Longer replacement periods are available in the case of real property and principle residences involuntary converted as a result of Presidentially declared disaster.

REASONS FOR CHANGE

The Committee is aware that Federal and State authorities are requiring owners of canker-infected or exposed citrus trees to burn such trees to limit the spread of this blight. The Committee also understands that the authorities are compensating the owners of infected citrus trees for the loss of such trees, and for the lost income those trees would have produced. The Committee is concerned that the inclusion of payment for lost income in the year the payment is received (or accrued) may result in high marginal tax rates for hard working owners of citrus trees. In addition, because the authorities generally preclude the replanting of citrus trees until the contaminated land is declared free of canker, the ability of citrus tree owners to use the tax favored treatment afforded other taxpayers from an involuntary conversion may not be available.

EXPLANATION OF PROVISION

The provision permits a taxpayer to elect to recognize any realized gain by reason of receiving a citrus canker tree payment ratably over a 10-year period beginning with the taxable year in which such payment is received or accrued by the taxpayer. The provision defines a citrus canker tree payment as a payment made to an owner of a commercial citrus grove to recover income that was lost as a result of the removal of commercial citrus trees to control canker under the amendments to the citrus canker regulations made by the final rule published in the Federal Register by the Secretary of the Agriculture on June 18, 2001. An election under the provision is made by attaching a statement to that effect in the taxpayer's return for the taxable year in which the payment is received or accrued in the manner as the Secretary prescribes. An election is binding for that taxable year and all subsequent taxable years.

The provision also extends the applicable period under section 1033 for a taxpayer to replace commercial citrus trees which are involuntarily converted under a public order as a result of citrus tree canker to four years after the close of the taxable year in which a State or Federal health authority determines that the land on which such trees grew is free from the bacteria that causes citrus tree canker.

EFFECTIVE DATE

The provision is effective for taxable years beginning before, on, or after the date of enactment.

D. ALLOWANCE OF ELECTRONIC FORMS 1099

(Sec. 904 of the bill)

PRESENT LAW

Temporary regulations allow Form W–2 to be furnished electronically on a voluntary basis. Under Temp. Treas. Reg.

§ 31.6051–1T(j), a recipient must have affirmatively consented to receive the statement electronically and must not have withdrawn that consent before the statement is furnished.

REASONS FOR CHANGE

Recent stresses have been placed on the United States Postal Service, the IRS, and taxpayers as a result of terrorist activities. The Committee believes that one step to be taken in relieving such stress is to reduce the amount of mail being sent to taxpayers who desire to receive information electronically.

EXPLANATION OF PROVISION

The provision allows IRS Form 1099 to be provided to taxpayers electronically, if they so consented. The authority is granted for forms due for taxable years ending before January 1, 2003.

EFFECTIVE DATE

The provision is effective on date of enactment.

E. Expand Exemption from Aviation Fuels Excise Taxes for Aerial Applicators

(Sec. 905 of the bill and Secs. 4081, 4091, and 4261 of the Code)

PRESENT LAW

Excise taxes are imposed on aviation gasoline (19.4 cents per gallon) and jet fuel (21.9 cents per gallon) (Secs. 4081 and 4091). All but 0.1 cent per gallon of the revenues from these taxes are dedicated to the Airport and Airway Trust Fund. The remaining 0.1-cent-per-gallon rate is imposed for the Leaking Underground Storage Tank Trust Fund.

Fuel used on a farm for farming purposes is exempt from tax. Aerial applicators (crop dusters) are allowed to claim the exemption on behalf of farm owners and operators, e.g., in the case of aviation gasoline if the owners or operators give written consent to the aerial applicators. This exemption applies only to fuel consumed in the airplane while operating over the farm, i.e., fuel consumed traveling to and from the farm is not exempt.

A further exemption applies to fuel used in helicopters engaged in oil, gas, and hard mineral exploration and timber operations when the helicopters are not using the Federally funded airport and airway services.

REASONS FOR CHANGE

The purpose of the aviation excise taxes is to generate revenue for the Airport Improvement program, which builds new and retrofits and expands existing public airports. The majority of agricultural aviation operators do not use public airports. In addition, the Committee believes that the Federal shutdown of the nation's airspace to re-establish national security after the September 11, 2001 attacks was damaging to agricultural aviation industry. In light of the foregoing, the Committee finds it appropriate to provide temporary excise tax relief for agricultural aviation operators.

EXPLANATION OF PROVISION

Three modifications are made to the exemptions for aviation fuel consumed by aerial applicators. First, the direct exemption beneficiary is changed to the aerial applicator in all cases. Second, the exemption is expanded to include fuels consumed when flying between the farm where chemicals are applied and the airport where the airplane takes off and lands. Third, the present exemption for helicopters engaged in timber operations is expanded to include fixed-wing aircraft.

EFFECTIVE DATE

The provision is effective for fuels consumed during calendar year 2002.

F. Recovery Period for Certain Wireless Telecommunications Equipment

(Sec. 906 of the bill and Sec. 168 of the Code)

PRESENT LAW

Depreciation allowances for property used in a trade or business generally are determined under the modified Accelerated Cost Recovery System ("MACRS") of section 168. Under MACRS, qualified technological equipment is depreciated for regular tax purposes over a 5-year recovery period using the 200-percent declining balance method. Qualified technological equipment includes any computer or peripheral equipment, any high technology station equipment installed on the customer's premises, and any high technology medical equipment.

REASONS FOR CHANGE

The Committee understands that wireless telecommunication service providers and the Internal Revenue Service have expended significant resources in auditing and settling disputes involving the depreciation of wireless telecommunications equipment. The Committee understands that one reason for these disputes is because assets used in the provision of wireless telecommunication services are not specifically assigned a recovery period. Although the Committee believes a comprehensive review of recovery periods and depreciation methods under section 168 is warranted, it believes a short-term moratorium on disputes is advantageous while global and specific depreciation reforms are further studied.

EXPLANATION OF PROVISION

The provision defines qualified technological equipment to include wireless telecommunications equipment for property placed in service after September 10, 2001 and before September 11, 2002. Wireless telecommunications equipment is defined as equipment used in the transmission, reception, coordination, or switching of wireless telecommunications service. Wireless telecommunications equipment does not include towers, buildings, T–1 lines and other cabling connecting cell sites to mobile switching centers. For this purpose, wireless telecommunications service includes any commercial mobile radio service as defined in title 47 of the Code of Federal Regulations.

EFFECTIVE DATE

The provision applies to wireless telecommunications equipment placed in service after September 10, 2001 and before September 11, 2002.[66]

G. IMPACT ON SOCIAL SECURITY TRUST FUNDS

(Sec. 907 of the bill)

PRESENT LAW

Present law provides for the transfer of social security taxes and certain self-employment taxes to the Social Security Trust Fund. In addition, the income taxes collected with respect to a portion of social security benefits included in gross income is transferred to the Social Security Trust Fund.

REASONS FOR CHANGE

The Committee finds it appropriate to ensure that the solvency of the Social Security Trust Fund is not negatively impacted by the provisions in the bill.

EXPLANATION OF PROVISION

The bill provides that the Secretary is to provide for appropriate transfers to the Social Security Trust Fund to ensure that balances in the fund are not negatively affected by the bill.

EFFECTIVE DATE

The provision is effective on the date of enactment.

H. EMERGENCY DESIGNATION

(Sec. 908 of the bill)

PRESENT LAW

Under the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, any legislation that reduces revenues or increases outlays is subject to a pay-as-you-go ("PAYGO") requirement. The PAYGO system tracks legislation that may increase budget deficits or decrease budget surpluses using a "scorecard" estimated by the Office of Management and Budget. Under PAYGO requirements, in order to avoid sequestration, any revenue loss or increase in outlays would need to be offset by revenue increases or reductions in direct spending.

If a provision of direct spending or receipts legislation is enacted that the President designates as an emergency requirement and that the Congress so designates in statute, the amounts of new budget authority, outlays, and receipts in all fiscal years resulting from that provision are not taken into account in determining the

[66] No inference is intended as to the proper treatment of wireless telecommunication equipment under present law.

PAYGO scorecard. In addition, certain points of order under the Congressional Budget Act would be nullified.

REASONS FOR CHANGE

The terrorist attacks of September 11, 2001, have had catastrophic consequences, not only for the victims of the attack, but for America as a whole. These events have rocked the economy; while some sectors may have been affected more than others, virtually all sectors of the economy are feeling an impact. Thousands of workers have lost their jobs, and more job losses may be expected as a result of these recent events. The extraordinary events of September 11 have created unforeseen, unpredictable, and unanticipated needs. The events and their aftermath have resulted in a sudden, urgent, pressing, and compelling need for legislation to address the consequences stemming from the attacks. The bill provides vital relief for victims of the attacks and those who have lost their jobs in the ensuing economic downturn, and needed economic stimulus to turn the economy around.

EXPLANATION OF PROVISION

The provision designates any revenue loss, new budget authority, and new outlays under the bill in excess of those allowed under the FY 2002 Budget Resolution as emergency requirements pursuant to section 252(e) of the Balanced Budget and Emergency Deficit Control Act of 1985 and Title III of the Congressional Budget Act.

EFFECTIVE DATE

The provision is effective on the date of enactment.