Summary of Modifications and Additions to the Baucus Substitute Amendment

The American Jobs and Closing Tax Loopholes Act, H.R. 4213

June 16, 2010[1]

Reduce Medicare physician payment update from 19 to 6 months. Medicare physician payment rates are scheduled to be reduced by more than 20 percent in June. This provision would reverse that reduction and provide a 2.2 percent update to physician payment rates through November 30, 2010. *This change will reduce the cost of the bill by $16.4 billion over 10 years.*

Eliminate the Extension of Federal Additional Compensation (FAC). Federal Additional Compensation, which increases unemployment benefits by $25 a week, was phased-out at the end of May 2010. The original Baucus substitute would have extended FAC through November 2010. This modification eliminates that extension of FAC. Under this bill, individuals that are currently receiving FAC will continue to receive FAC until the exhaustion of all benefit programs, but no later than the end of the week beginning December 7, 2010. The non-reduction rule for FAC also continues to apply through the end of the week beginning December 7, 2010. In addition, the "non-reduction rule" has been attached to the Emergency Unemployment Compensation (EUC) provision. *This change will reduce the cost of the bill by $5.8 billion over 10 years.*

Changes to the taxation of carried interest. The bill would prevent investment fund managers from paying taxes entirely at capital gains rates on investment management services income received as carried interest in an investment fund. To the extent that carried interest reflects a return on invested capital, the bill would continue to tax carried interest at capital gain tax rates. However, to the extent that carried interest does not reflect a return on invested capital, this amendment would require investment fund managers to treat seventy-five percent (75%) of the remaining carried interest as ordinary income beginning on January 1, 2011. The amount that will be treated as ordinary income is reduced to fifty percent (50%) for carried interest that does not reflect a return on invested capital but which is attributable to the sale of assets which are held for 5 or more years. This amendment provides that the lower recharacterization percentage also applies to the gain or loss attributable to the underlying assets held for 5 or more years when a partnership interest is sold as well as to gain attributable to section 197 intangibles of a partnership whose principal activity is providing specific investment management services with respect to the assets of the partnership when the partnership interest has been held for 5 or more years. This amendment also provides that, on selling an interest in any publicly traded partnership, a person who is not an investment service provider will be exempt from the rule that recharacterizes as ordinary income under Internal Revenue Code section 751(a) that portion of the gain or loss attributable to an investment services partnership interest. *This proposal, as amended, is estimated to raise $13.905 billion over 10 years.*

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[1] *All scores in this document are preliminary and subject to change.*

Changes to Employment Taxes on Earning of Certain Service Professionals. Social Security taxes are imposed on compensation and self-employment income up to the Social Security Wage Base (currently $106,800) and the Medicare tax is imposed on all self-employment and compensation income. Some service professionals have been avoiding Medicare and Social Security taxes by routing their self-employment income through an S corporation. These taxpayers then pay themselves a nominal salary and take the position that the remaining earnings are exempt from employment taxes. A provision passed by the House and included in the original Baucus substitute would address this abuse in situations where (1) an S corporation is a partner in a professional service business or (2) an S corporation is engaged in a professional service business that is principally based on the reputation and skill of 3 or fewer individuals. This provision does not change the ability of S corporations to use some income to make business investments or deduct those small business investments. To make the second alternative more administrable and more targeted, this amendment changes the language so that the policy applies only if 80 percent or more of the professional service income of the corporation is attributable to the services of 3 or fewer owners of the corporation. *This proposal, as amended, is estimated to raise $9.15 billion over 10 years.*

Increase Oil Spill Liability Trust Fund solvency. The Oil Spill Liability Trust fund is financed by an 8-cent-per-barrel tax on the oil industry. There is approximately $1.5 billion available in this trust fund. The nonpartisan Congressional Research Service has stated, "a major spill, particularly one in a sensitive environment, could threaten the viability of the fund." To ensure the continued solvency of the Oil Spill Liability Trust Fund, the bill would increase the per-barrel amount that oil companies are required to pay into the fund to 49 cents. *This proposal, as amended, is estimated to raise $18.3 billion over 10 years.*

Addition of the Modification to the Section 6707A Penalty. The bill revises section 6707A of the Internal Revenue Code to make the penalty for failing to disclose a reportable transaction proportionate to the underlying tax savings. The purpose of this change is to prevent small businesses from paying a penalty significantly greater than the benefit they would receive from their investment. The penalty for failure to disclose reportable transactions to the IRS would be set at 75 percent of the tax benefit received. Reportable transactions are defined as investments in transactions that the IRS has identified as listed tax shelters or that have characteristics of tax shelters, including large losses or confidentiality agreements. The minimum penalty under this bill is $10,000 for corporations and $5,000 for individuals, and the maximum penalty is $200,000 for corporations and $100,000 for individuals. The bill also requires the IRS to provide an annual report to the Senate Finance Committee and to the House Ways and Means Committee giving an account of certain tax-shelter related penalties asserted during the year. *This proposal, which passed the Senate by unanimous consent in December of 2009, is estimated to cost $176 million over ten years.*

Addition of Clarification for Affiliated Hospitals for Distribution of Residency Positions. The bill would make a technical correction to clarify that residency positions being used as part of an affiliation agreement between teaching hospitals would not be considered unused residency positions, for the purpose of the redistribution of GME slots under current law. *This provision is estimated to save approximately $50 million over 10 years.*

Addition of Disaster Low-Income Housing Tax Credits. Under current law, every year states receive allocations of low-income housing tax credits (LIHTC) based on population or a small state set-aside. In response to Hurricane Katrina in 2005, as well as the floods in the Midwest in 2007, the LIHTC was expanded to allow for additional credits, called "disaster credits", to help affected states rebuild. This amount is on top of what States receive under current law. As part of the American Recovery and Reinvestment Act of 2009, LIHTCs are eligible to be exchanged for grants. This exchange program only applies to LIHTCs allocated based on population – it did not apply to disaster credits. In the underlying bill, LITHCs allocated in 2010 are eligible to be refundable credits. This provision also allows disaster credits from the Katrina and Midwestern flood disasters to be exchanged for either grants or refundable credits. *The provision is estimated to cost $91 million over 10 years.*

Addition of Extension of Closing Date for Homebuyer Tax Credit. As part of the Worker, Homeownership, and Business Assistance Act of 2009, the homebuyer tax credit was expanded and extended to allow homebuyers to receive a tax credit for the purchase of a qualifying home through April 30, 2010. Homebuyers can benefit from the tax credit up to July 1, 2010 if they entered into a binding contract by April 30, 2010 and close on the home within 60 days. This provision extends the closing date for homebuyers who entered into a binding contract by April 30, 2010, allowing them to be eligible for the tax credit if they close on the home before October 1, 2010. *The provision is estimated to cost $140 million over 10 years.*

Addition of Denial of Deductions for Punitive Damages. Under current law, a deduction is allowed for damages paid or incurred as ordinary and necessary expense in the course of a trade or business. However, no deduction is allowed for a fine or penalty paid to a government for the violation of any law. If a taxpayer is convicted in violation of antitrust laws, no deduction is allowed for two-thirds of any amount paid or incurred on a judgment or settlement. This provision denies a tax deduction for payments made for punitive damages in connection with any legal judgment or settlement. Additionally, in the case that a taxpayer's punitive damages are paid by an insurer, the amounts paid on behalf of the taxpayer are included in the taxpayer's gross income. This provision applies to damages paid or incurred after December 31, 2011. *The provision is estimated to raise $315 million over 10 years.*

Foreign tax loophole closer clarification regarding the source rules for income on guarantees. The provision would reverse a recent Tax Court decision to provide that guarantee payments made to foreign persons are treated like interest, rather than services, and therefore subject to U.S. withholding tax when paid by a U.S. person to a foreign person. The modification would clarify that the provision only applies to guarantees of indebtedness (rather than to guarantees of obligations). *The clarification has no revenue effect.*

Foreign tax loophole closer clarification regarding the provision that would terminate the special rules for interest and dividends received from "80/20 companies". The provision would eliminate the withholding and foreign tax credit benefit for 80/20 companies prospectively, subject to a "grandfather" rule that would continue to provide favorable withholding tax treatment to payments made by existing legitimate 80/20 companies. The modification would clarify that for purposes of applying the grandfather provision for periods prior to January 1, 2011, the 80/20 rules then in effect shall apply. *The clarification has no revenue effect.*