JOINT COMMITTEE ON TAXATION
July 9, 2014
JCX-83-14

DESCRIPTION OF THE CHAIRMAN'S SECOND MODIFICATION TO THE PROVISIONS OF THE "PRESERVING AMERICA'S TRANSIT AND HIGHWAYS ACT OF 2014"

The following additional modifications are made to the provisions of the Preserving America's Transit and Highways Act of 2014.

I. ADDITIONAL MODIFICATIONS TO THE PRESERVING AMERICA'S TRANSIT AND HIGHWAYS ACT OF 2014

A. Highway Trust Fund Expenditure Authority

The Chairman's second modification strikes the date "December 31, 2014" from the expenditure authority proposal. The Chairman's second modification also transfers $7.824 billion from the General Fund to the Highway Account of the Highway Trust Fund, and transfers $2 billion from the General Fund to the Mass Transit Account of the Highway Trust Fund.

B. Mortgage Reporting

The Chairman's second modification delays the effective date of the mortgage reporting proposal such that the proposal, as modified, applies to returns and statements due after December 31, 2015.

C. Revocation or Denial of Passport in Case of Certain Unpaid Taxes

The Chairman's second modification removes the proposal denying a passport (or renewal of a passport) to a seriously delinquent taxpayer and permitting the revocation of any passport previously issued to such person.

D. Modification of Required Distribution Rules for Pension Plans

The Chairman's second modification removes the proposal relating to modification of the required distribution rules for employer-sponsored retirement plans and individual retirement arrangements.

E. Transferring Funds from the Leaking Underground Storage Tank Trust Fund to the Highway Trust Fund

The Chairman's second modification transfers $1 billion (instead of $750 million) from the Leaking Underground Storage Tank Trust Fund to the Highway Account of the Highway Trust Fund.

F. Require Paid Tax Return Preparers to Meet Due Diligence Requirements for the American Opportunity Tax Credit

The Chairman's second modification removes the proposal requiring paid tax return preparers to meet certain due diligence requirements in the case of tax returns claiming the American Opportunity tax credit.

II. NEW PROVISIONS

A. Penalty for Failure to Meet the Due Diligence Requirements for the Child Tax Credit

Present Law

Eligibility requirements for certain refundable credits

Two refundable credits available to individuals use both income level and the presence and number of qualifying children as factors in determining eligibility for the credit: the child tax credit[1] and the earned income credit ("EIC").[2] Eligibility for the EIC is based on earned income, adjusted gross income, investment income, filing status, number of children, and immigration and work status in the United States. The EIC generally equals a specified percentage of earned income up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For taxpayers with earned income (or adjusted gross income ("AGI"), if greater) in excess of the beginning of the phaseout range, the maximum EIC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

An individual is not eligible for the EIC if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $3,350 (for 2014). This threshold is indexed for inflation. Disqualified income is the sum of: (1) interest (both taxable and tax exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gains net income; and (5) net passive income that is not self-employment income (if greater than zero).

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[1] Sec. 24.

[2] Sec. 32.

An individual may claim a child tax credit of $1,000 for each qualifying child under the age of 17,[3] provided that the child is a citizen, national, or resident of the United States.[4] The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.[5] If the resulting child credit exceeds the tax liability of the taxpayer, the taxpayer is eligible for a refundable credit (known as the additional child tax credit)[6] equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). Prior to 2009, the threshold dollar amount was $10,000 and was indexed for inflation. For taxable years beginning after 2009 and before January 1, 2018, the threshold amount is $3,000, and is not indexed for inflation. The $3,000 threshold is currently scheduled to expire for taxable years beginning after December 31, 2017, after which the threshold reverts to the indexed $10,000 amount.

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

<u>Diligence required by return preparers for EIC claimants</u>

Under section 6695(g), a penalty of $500 may be imposed on a person who, as a tax return preparer,[7] prepares a tax return for a taxpayer claiming the earned income credit ("EIC"),[8] unless the tax return preparer exercises due diligence with respect to that claim. The due diligence requirements extend to both the determination of eligibility for the credit and the amount of the credit, as prescribed by regulations, which also detail how to document one's compliance with those requirements.[9] The position taken with respect to the EIC must be based on current and reasonable information that the paid preparer develops, either directly from the taxpayer or by other reasonable means. The preparer may not ignore implications of information

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[3] Sec. 24(a).

[4] Sec. 24(c).

[5] Sec. 24(b).

[6] Sec. 24(d).

[7] Sec. 7701(a)(36) provides a general definition of tax return preparer to include persons who are compensated to prepare all or a substantial portion of a return or claim for refund, with certain exceptions.

[8] Sec. 32.

[9] Treas. Reg. sec. 1.6695-2(b).

provided by taxpayers, and is expected to make reasonable inquiries about incorrect, inconsistent or incomplete information.

The conclusions about eligibility and computation, as well as the steps taken to develop those conclusions, must be documented, using Form 8867, "Paid Preparer's Earned Income Credit Checklist," which is filed with the return.[10] The basis for the computation of the credit must also be documented, either on a Computation Worksheet, or in an alternative record containing the requisite information. The preparer is required to maintain that documentation for three years.

The penalty may be waived with respect to a particular return or claim for refund on the basis of all facts and circumstances. The preparer must establish that he routinely follows reasonable office procedures to ensure compliance. The failure to comply with the requirements must be isolated and inadvertent.[11] The enhanced duties of due diligence required with respect to the EIC do not extend to other refundable credits.

Description of Proposal

The proposal requires paid tax return preparers who prepare Federal income tax returns on which a child (or additional child) tax credit is claimed to meet due diligence requirements similar to those applicable to returns claiming an earned income tax credit. The proposal anticipates that the checklist presently required by regulations will be adapted by the IRS to address both the child tax credit and the EIC and to highlight differences between the two credits. In adapting the checklist, the IRS is to ensure that it imposes minimal additional burden on taxpayers and paid preparers.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2014.

B. Pension Funding Stabilization

Present Law

Minimum funding rules

A defined benefit plan maintained by a single employer is subject to minimum funding rules that generally require the sponsoring employer to make a certain level of contribution for

[10] If the return preparer electronically files the return or claim for refund for the taxpayer, the Form 8867 is filed electronically with the return. If the prepared return or claim for refund is given to the taxpayer to file, the Form 8867 is provided to the taxpayer at the same time, to submit with the return or claim for refund.

[11] Treas. Reg. sec. 1.6695-2(d).

each plan year to fund plan benefits.[12] The minimum funding rules for single-employer defined benefit plans were substantially revised by the Pension Protection Act of 2006 ("PPA").[13]

Minimum required contributions

In general

The minimum required contribution for a plan year for a single-employer defined benefit plan generally depends on a comparison of the value of the plan's assets, reduced by any prefunding balance or funding standard carryover balance ("net value of plan assets"),[14] with the plan's funding target and target normal cost. The plan's funding target for a plan year is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is generally the present value of benefits expected to accrue or to be earned during the plan year.

If the net value of plan assets is less than the plan's funding target, so that the plan has a funding shortfall (discussed further below), the minimum required contribution is the sum of the plan's target normal cost and the shortfall amortization charge for the plan year (determined as described below).[15] If the net value of plan assets is equal to or exceeds the plan's funding target, the minimum required contribution is the plan's target normal cost, reduced by the amount, if any, by which the net value of plan assets exceeds the plan's funding target.

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[12] Sec. 412 of the Code and section 302 of the Employee Retirement Income Security Act of 1974 ("ERISA"). For purposes of whether a plan is maintained by a single employer, certain related entities, such as the members of a controlled group, are treated as a single employer. Different funding rules apply to multiemployer and multiple-employer defined benefit plans, which are types of plans maintained by two or more unrelated employers. A number of exceptions to the minimum funding rules apply. For example, governmental plans (within the meaning of section 414(d) and church plans (within the meaning of section 414(e)) are generally not subject to the minimum funding rules. Under section 4971, an excise tax applies if the minimum funding requirements are not satisfied.

[13] Pub. L. No. 109-280. The PPA minimum funding rules for single-employer plans are generally effective for plan years beginning after December 31, 2007. Subsequent changes were made by the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"), Pub. L. No. 110-458; the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 ("PRA 2010"), Pub. L. No. 111-192; and the Moving Ahead for Progress in the 21st Century Act ("MAP-21"), Pub. L. No. 112-141, discussed further herein.

[14] The value of plan assets is generally reduced by any prefunding balance or funding standard carryover balance in determining minimum required contributions. A prefunding balance results from plan contributions that exceed the minimum required contributions. A funding standard carryover balance results from a positive balance in the funding standard account that applied under the funding requirements in effect before PPA. Subject to certain conditions, a prefunding balance or funding standard carryover balance may be credited against the minimum required contribution for a year, reducing the amount that must be contributed.

[15] If the plan has obtained a waiver of the minimum required contribution (a funding waiver) within the past five years, the minimum required contribution also includes the related waiver amortization charge, that is, the annual installment needed to amortize the waived amount in level installments over the five years following the year of the waiver.

Shortfall amortization charge

The shortfall amortization charge for a plan year is the sum of the annual shortfall amortization installments attributable to the shortfall bases for that plan year and the six previous plan years. Generally, if a plan has a funding shortfall for the plan year, a shortfall amortization base must be established for the plan year.[16] A plan's funding shortfall is the amount by which the plan's funding target exceeds the net value of plan assets. The shortfall amortization base for a plan year is: (1) the plan's funding shortfall, minus (2) the present value, determined using the segment interest rates (discussed below), of the aggregate total of the shortfall amortization installments that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases for the six previous plan years. The shortfall amortization base is amortized in level annual installments ("shortfall amortization installments") over a seven-year period beginning with the current plan year and using the segment interest rates (discussed below).[17]

The shortfall amortization base for a plan year may be positive or negative, depending on whether the present value of remaining installments with respect to amortization bases for previous years is more or less than the plan's funding shortfall. If the shortfall amortization base is positive (that is, the funding shortfall exceeds the present value of the remaining installments), the related shortfall amortization installments are positive. If the shortfall amortization base is negative, the related shortfall amortization installments are negative. The positive and negative shortfall amortization installments for a particular plan year are netted when adding them up in determining the shortfall amortization charge for the plan year, but the resulting shortfall amortization charge cannot be less than zero (i.e., negative amortization installments may not offset normal cost).

If the net value of plan assets for a plan year is at least equal to the plan's funding target for the year, so the plan has no funding shortfall, any shortfall amortization bases and related shortfall amortization installments are eliminated.[18] As indicated above, if the net value of plan assets exceeds the plan's funding target, the excess is applied against target normal cost in determining the minimum required contribution.

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[16] If the value of plan assets, reduced only by any prefunding balance if the employer elects to apply the prefunding balance against the required contribution for the plan year, is at least equal to the plan's funding target, no shortfall amortization base is established for the year.

[17] Under PRA 2010, employers were permitted to elect to use one of two alternative extended amortization schedules for up to two "eligible" plan years during the period 2008-2011. The use of an extended amortization schedule has the effect of reducing the amount of the shortfall amortization installments attributable to the shortfall amortization base for the eligible plan year. However, the shortfall amortization installments attributable to an eligible plan year may be increased by an additional amount, an "installment acceleration amount," in the case of employee compensation exceeding $1 million, extraordinary dividends, or stock redemptions within a certain period of the eligible plan year.

[18] Any amortization base relating to a funding waiver for a previous year is also eliminated.

Interest rate used to determine target normal cost and funding target

The minimum funding rules for single-employer plans specify the interest rates and certain other actuarial assumptions that must be used in determining the present value of benefits for purposes of a plan's target normal cost and funding target.

Present value is generally determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period.[19] The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year;[20] the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period. Under the funding rules as enacted in PPA ("PPA" rules), each segment rate is a single interest rate determined monthly by the Secretary of the Treasury ("Secretary"), on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. The corporate bond yield curve used for this purpose reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. The Internal Revenue Service ("IRS") publishes the segment rates each month.

Under the Moving Ahead for Progress in the 21st Century Act ("MAP-21"), for plan years beginning after December 31, 2011, a segment rate determined under the PPA rules is adjusted if it falls outside a specified percentage range of the average segment rates for a preceding period. In particular, if a segment rate determined under the PPA rules is less than the applicable minimum percentage in the specified range, the segment rate is adjusted upward to match the minimum percentage. If a segment rate determined under the PPA rules is more than the applicable maximum percentage in the specified range, the segment rate is adjusted downward to match the maximum percentage. For this purpose, an average segment rate is the average of the segment rates determined under the PPA rules for the 25-year period ending September 30 of the calendar year preceding the calendar year in which the plan year begins. The Secretary is to determine average segment rates on an annual basis and may prescribe equivalent rates for any years in the 25-year period for which segment rates determined under the PPA rules are not available. The Secretary is directed to publish the average segment rates each month.

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[19] Solely for purposes of determining minimum required contributions, in lieu of the segment rates, an employer may elect to use interest rates on a yield curve based on the yields on investment grade corporate bonds for the month preceding the month in which the plan year begins (*i.e.*, without regard to the 24-month averaging described above) ("monthly yield curve"). If an election to use a monthly yield curve is made, it cannot be revoked without IRS approval.

[20] Subject to an exception for small plans with no more than 100 participants, the annual valuation date for a plan must be the first day of the plan year. Thus, except for small plans with valuation dates other than the first day of the plan year, the period for which the first segment rate applies begins on the valuation date.

The specified percentage range (that is, the range from the applicable minimum percentage to the applicable maximum percentage) for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012,
- 85 percent to 115 percent for 2013,
- 80 percent to 120 percent for 2014,
- 75 percent to 125 percent for 2015, and
- 70 percent to 130 percent for 2016 or later.

Funding-related benefit restrictions

Special rules may apply to a plan if its funding target attainment percentage is below a certain level.[21] A plan's funding target attainment percentage for a plan year is the ratio, expressed as a percentage, that the net value of plan assets bears to the plan's funding target for the year. Because a plan's funding target is a component of the plan's funding target attainment percentage, the interest rate used in determining the plan's funding target generally applies also in determining the plan's funding target attainment percentage.[22]

Restrictions on benefit increases, certain types of benefit payments ("prohibited payments") and benefit accruals (collectively referred to as "benefit restrictions") may apply to a plan if the plan's adjusted funding target attainment percentage is below a certain level.[23] The plan's adjusted funding target attainment percentage is determined in the same way as funding target attainment percentage, except that the net value of plan assets and the plan's funding target are both increased by the aggregate amount of purchases of annuities for employees, other than highly compensated employees, made by the plan during the two preceding plan years. Although anti-cutback rules generally prohibit reductions in benefits that have already been earned under a plan,[24] reductions required to comply with the benefit restrictions are permitted.

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[21] For example, funding target attainment percentage is used to determine whether a plan is in "at-risk" status, so that special actuarial assumptions ("at-risk assumptions") must be used in determining the plan's funding target and target normal cost. A plan is in at risk status for a plan year if, for the preceding year: (1) the plan's funding target attainment percentage, determined without regard to the at-risk assumptions, was less than 80 percent, and (2) the plan's funding target attainment percentage, determined using the at-risk assumptions (without regard to whether the plan was in at-risk status for the preceding year), was less than 70 percent. A similar test applies in order for an employer to be permitted to apply a prefunding balance against its required contribution, that is, for the preceding year, the ratio of the value of plan assets (reduced by any prefunding balance) must be at least 80 percent of the plan's funding target (determined without regard to the at-risk rules).

[22] The adjustments to the segment rates under MAP-21 do not apply for certain other purposes for which the segment rates are used, for example, in calculating the limits on deductible contributions to single-employer defined benefit plans under section 404.

[23] Code secs. 401(a)(29) and 436 and ERISA sec. 206(g).

[24] Code sec. 411(d)(6) and ERISA sec. 204(g).

Under these rules, a prohibited payment generally means (1) any payment in excess of the monthly benefit amount paid under a single life annuity (plus any social security supplement), or (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits. Prohibited payments generally may not be made if the plan's adjusted funding target attainment percentage is less than 60 percent. If a plan's adjusted funding target attainment percentage is at least 60 percent, but less than 80 percent, prohibited payments may be made, but subject to limits. In addition, prohibited payments may not be made during any period in which the plan sponsor is a debtor in a bankruptcy proceeding under Federal or State law unless the plan's adjusted funding target attainment percentage is at least 100 percent.

Annual funding notice

The plan administrator of a single-employer defined benefit plan must provide an annual funding notice to each participant and beneficiary, each labor organization representing such participants or beneficiaries, and the Pension Benefit Guaranty Corporation ("PBGC").[25] In addition to the information required to be provided in all funding notices, in the case of a single-employer defined benefit plan, the notice must include (1) the plan's funding target attainment percentage for the plan year to which the notice relates and the two preceding plan years, (2) the value of the plan's assets and benefit liabilities (that is, the present value of benefits owed under the plan) for the plan year and the two preceding years, determined in the same manner as under the funding rules, and (3) the value of the plan's assets and benefit liabilities as of the last day of the plan year to which the notice relates, determined using the fair market value of plan assets (rather value determined under the funding rules) and, in computing benefit liabilities, the interest rates used in computing variable-rate PBGC premiums.[26]

Under MAP-21, additional information must be included in the annual funding notice in the case of an applicable plan year. For this purpose, an applicable plan year is any plan year beginning after December 31, 2011, and before January 1, 2015, for which (1) the plan's funding target, determined using segment rates as adjusted to reflect average segment rates ("adjusted" segment rates), is less than 95 percent of the funding target determined without regard to adjusted segment rates, (2) the plan has a funding shortfall, determined without regard to adjusted segment rates, greater than $500,000, and (3) the plan had 50 or more participants on any day during the preceding plan year. Specifically, the notice must include (1) a statement that MAP-21 modified the method for determining the interest rates used to determine the actuarial value of benefits earned under the plan, providing for a 25-year average of interest rates to be taken into account in addition to a two-year average, (2) a statement that, as a result of MAP-21,

[25] ERISA sec. 101(f), originally enacted by section 103 of the Pension Funding Equity Act of 2004, Pub. L. No. 108-218. Annual funding notice requirements, with some differences, apply also to multiemployer and multiple-employer plans.

[26] In applying the funding rules, the value of plan assets may be determined on the basis of average fair market values over a period of up to 24 months. PBGC variable-rate premiums are based on a plan's unfunded vested benefit liabilities, computed using the first, second and third segment rates as determined under the PPA rules (without adjustments under MAP-21), but based on a monthly corporate bond yield curve, rather than a yield curve reflecting average yields for a 24-month period.

the plan sponsor may contribute less money to the plan when interest rates are at historical lows, and (3) a table showing, for the applicable plan year and each of the two preceding plan years,[27] the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution, each determined both using adjusted segment rates and without regard to adjusted segment rates.

Description of Proposal

Applicable minimum and maximum percentages and annual funding notice

The proposal revises the specified percentage ranges (that is, the range from the applicable minimum percentage to the applicable maximum percentage of average segment rates) for determining whether a segment rate must be adjusted upward or downward. Under the proposal, the specified percentage range for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012 through 2015,
- 85 percent to 115 percent for 2016,
- 80 percent to 120 percent for 2017,
- 75 percent to 125 percent for 2018, and
- 70 percent to 130 percent for 2019 or later.

In addition, for purposes of the additional information that must be provided in a funding notice for an applicable plan year, an applicable plan year includes any plan year that begins after December 31, 2011, and before January 1, 2020, and that otherwise meets the definition of applicable plan year.

Prohibited payments in bankruptcy

Under the proposal, the adjusted segment rates do not apply for purposes of whether prohibited payments may be made from a plan during a period in which the plan sponsor is a debtor in a bankruptcy proceeding under Federal or State law, that is, for purposes of determining whether the plan's adjusted funding target attainment percentage is at least 100 percent. Thus, the plan's adjusted funding target attainment percentage, determined without regard to the adjusted segment rates, must be at least 100 percent in order for prohibited payments to be made.

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[27] In the case of a preceding plan year beginning before January 1, 2012, only the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution determined without regard to adjusted segment rates are required to be provided.

Periods for determining segment rates

The proposal revises the period of benefit payments to which the segment rates (or adjusted segment rates) apply. Under the proposal, the first rate applies to benefits reasonably determined to be payable during the five-year period beginning on the plan's valuation date (rather than the first day of the plan year as under present law); the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period.[28]

Effective Date

The proposals relating to the applicable minimum and maximum percentages, the annual funding notice, and periods for determining segment rates are generally effective for plan years beginning after December 31, 2012. Under a special rule, an employer may elect, for any plan year beginning before January 1, 2014, not to have these proposals apply either (1) for all purposes for which the proposals would otherwise apply, or (2) solely for purposes of determining the plan's adjusted funding target attainment percentage in applying the benefit restrictions for that year. A plan will not be treated as failing to meet the requirements of the anti-cutback rules solely by reason of an election under the special rule.

The proposal relating to prohibited payments in bankruptcy generally applies to plan years beginning after December 31, 2014, or, in the case of a plan maintained pursuant to one or more collective bargaining agreements, to plan years beginning after December 31, 2015. If certain requirements are met, a plan amendment made pursuant to the proposal may be retroactively effective, the plan will be treated as being operated in accordance with its terms during the period before the amendment, and the plan will not be treated as failing to meet the requirements of the anti-cutback rules solely by reason of the amendment. In order for this treatment to apply, the amendment must be made pursuant to the proposal (or pursuant to any regulation issued by the Secretary or the Secretary of Labor under the proposal), and the amendment must be made by the last day of the first plan year beginning on or after January 1, 2016, or such later date as the Secretary prescribes. In addition, the plan must be operated as if the plan amendment were in effect during the period (1) beginning on the date the proposal (or regulation) takes effect (or, in the case of a plan amendment not required by the proposal or regulation, the effective date specified in the plan), and (2) ending on the last day of the first plan year beginning on or after January 1, 2016, or such later date as the Secretary prescribes (or, if earlier, the date the amendment is adopted). The amendment must also apply retroactively for that period.

[28] The proposal does not change the requirement that the valuation date for plans other than certain small plans must be the first day of the plan year. Thus, the proposal does not change these periods for plans for which the valuation date must be the first day of the plan year.

C. Merchandise Processing Fee

Present Law

In general, section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") requires the Secretary of Treasury to charge and collect a fee of .3464 percent *ad valorem* on merchandise formally entered or released into the United States. The provision will expire on June 30, 2021.

Description of Proposal

The proposal would extend the merchandise processing fee and extend the .3464 percent rate until January 7, 2024.

Effective Date

The proposal is effective on the date of enactment.

D. Customs User Fees

Present Law

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") authorizes the Secretary of the Treasury to collect certain service fees. The current authorization for the collection of the merchandise processing fee is through September 30, 2023.

Description of Proposal

The proposal extends the merchandise processing fees authorized under section 13031(j)(3)(A) of COBRA through January 7, 2024.

Effective Date

The proposal is effective on the date of enactment.

E. 100 Percent Continuous Levy Authority on Payments to Medicare Providers and Suppliers

Present Law

In general

Levy is the administrative authority of the IRS to seize a taxpayer's property, or rights to property, to pay the taxpayer's tax liability.[29] Generally, the IRS is entitled to seize a taxpayer's property by levy if a Federal tax lien has attached to such property,[30] the property is not exempt from levy,[31] and the IRS has provided both notice of intention to levy[32] and notice of the right to an administrative hearing (the notice is referred to as a "collections due process notice" or "CDP notice" and the hearing is referred to as the "CDP hearing")[33] at least 30 days before the levy is made. A levy on salary or wages generally is continuously in effect until released.[34] A Federal tax lien arises automatically when: (1) a tax assessment has been made; (2) the taxpayer has been given notice of the assessment stating the amount and demanding payment; and (3) the taxpayer has failed to pay the amount assessed within 10 days after the notice and demand.[35]

The notice of intent to levy is not required if the Secretary finds that collection would be jeopardized by delay. The standard for determining whether jeopardy exists is similar to the standard applicable when determining whether assessment of tax without following the normal deficiency procedures is permitted.[36]

The CDP notice (and pre-levy CDP hearing) is not required if: (1) the Secretary finds that collection would be jeopardized by delay; (2) the Secretary has served a levy on a State to collect a Federal tax liability from a State tax refund; (3) the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the beginning of the taxable period with respect to which the employment tax levy is served; or (4) the Secretary has served a Federal contractor levy. In each of these four cases,

[29] Sec. 6331(a). Levy specifically refers to the legal process by which the IRS orders a third party to turn over property in its possession that belongs to the delinquent taxpayer named in a notice of levy.

[30] *Ibid*.

[31] Sec. 6334.

[32] Sec. 6331(d).

[33] Sec. 6330. The notice and the hearing are referred to collectively as the CDP requirements.

[34] Secs. 6331(e) and 6343.

[35] Sec. 6321.

[36] Secs. 6331(d)(3), 6861.

however, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy.[37]

Federal payment levy program

To help the IRS collect taxes more effectively, the Taxpayer Relief Act of 1997[38] authorized the establishment of the Federal Payment Levy Program ("FPLP"), which allows the IRS to continuously levy up to 15 percent of certain "specified payments" by the Federal government if the payees are delinquent on their tax obligations. With respect to payments to vendors of goods, services, or property sold or leased to the Federal government, the continuous levy may be up to 100 percent of each payment.[39] For payments to Medicare providers and suppliers, the levy is up to 15 percent. The levy (either up to 15 percent or up to 100 percent) generally continues in effect until the liability is paid or the IRS releases the levy.

Under FPLP, the IRS matches its accounts receivable records with Federal payment records maintained by the Department of the Treasury's Financial Management Service ("FMS"), such as certain Social Security benefit and Federal wage records. When these records match, the delinquent taxpayer is provided both the notice of intention to levy and the CDP notice. If the taxpayer does not respond after 30 days, the IRS can instruct FMS to levy the taxpayer's Federal payments. Subsequent payments are continuously levied until such time that the tax debt is paid or the IRS releases the levy.

Description of Proposal

The proposal allows the Secretary to levy up to 100 percent of payments to Medicare providers and suppliers to collect unpaid taxes.

Effective Date

The proposal is effective for payments made on or after the date that is six months after the date of enactment.

F. Liquefied Petroleum Gas Equalization

Present Law

The Code imposes an excise tax on gasoline, diesel fuel, kerosene, and certain alternative fuels at the following rates:[40]

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[37] Sec. 6330(f).

[38] Pub. L. No. 105-34.

[39] Sec. 6331(h)(3).

[40] These fuels are subject to an additional 0.1-cent-per-gallon excise tax to fund the Leaking Underground Storage Tank ("LUST") Trust Fund (secs. 4041(d) and 4081(a)(2)(B)). That tax is imposed as an "add-on" to other existing taxes.

Gasoline	18.3 cents per gallon
Diesel fuel and kerosene	24.3 cents per gallon[41]
Alternative fuels	24.3 and 18.3 cents per gallon[42]

The Code imposes tax on gasoline, diesel fuel, and kerosene upon removal from a refinery or on importation, unless the fuel is transferred in bulk by registered pipeline or barge to a registered terminal facility.[43] The imposition of tax on alternative fuels generally occurs at retail when the fuel is sold to an owner, lessee or other operator of a motor vehicle or motorboat for use as a fuel in such motor vehicle or motorboat.

One such alternative fuel is liquefied petroleum gas (also known as propane). Liquefied petroleum gas is taxed at the same per gallon rate as gasoline, 18.3 cents per gallon. According to the Department of Energy Alternative Fuels Data Center, gasoline has an energy content of 116,090 Btu per gallon (lower heating value), and liquefied petroleum gas has an energy content of 84,950 Btu per gallon (lower heating value). Therefore, a gallon of liquefied petroleum gas produces approximately 73 percent of the energy produced by a gallon of gasoline.

Description of Proposal

The proposal changes the tax rate of liquefied petroleum gas to a rate based on its energy equivalent of a gallon of gasoline (13.4 cents per gallon).

Effective Date

The proposal is effective for fuel sold or used after September 30, 2014.

G. Modify Tax Exemption Requirements for Mutual Ditch or Irrigation Companies

Present Law

Under section 501(c)(12), certain mutual or cooperative organizations are exempt from Federal income tax under section 501(a), provided that certain requirements are satisfied. These organizations include: (1) benevolent life insurance associations of a purely local character; (2)

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[41] Diesel-water emulsions are taxed at 19.7 cents per gallon (sec. 4081(a)(2)(D)).

[42] The rate of tax is 24.3 cents per gallon in the case of liquefied natural gas, any liquid fuel (other than ethanol or methanol) derived from coal, and liquid hydrocarbons derived from biomass. Other alternative fuels sold or used as motor fuel are generally taxed at 18.3 cents per gallon. "Alternative fuel" also includes compressed natural gas. The rate for compressed natural gas is 18.3 cents per energy equivalent of a gallon of gasoline. *See* sec. 4041(a)(2) and (3).

[43] Sec. 4081(a)(1).

mutual ditch or irrigation companies; (3) mutual or cooperative telephone companies; and (4) like organizations of organizations described in (1), (2), or (3).[44]

To qualify for exemption under section 501(c)(12), at least 85 percent of the organization's income must consist of amounts collected from members for the sole purpose of meeting losses and expenses.[45] The 85-percent test is applied on a year-by-year basis. If an organization fails to satisfy the test for a year, it does not qualify for exemption for that particular year; it may, however, continue to qualify for exemption for any year for which the 85-percent test is satisfied. Present law includes special rules regarding the treatment of certain specific types of income under the 85-percent test for mutual or cooperative electric and telephone companies, but not for other types of organizations described in section 501(c)(12).[46]

The IRS takes the position that mutual or cooperative organizations described in section 501(c)(12) also must comply with fundamental cooperative principles.[47] Although not defined by statute or regulation, the two principal criteria for determining whether an entity is operating on a cooperative basis are: (1) ownership of the cooperative by persons who patronize the cooperative; and (2) return of earnings to patrons in proportion to their patronage. The IRS requires that cooperatives must operate under the following principles: (1) subordination of capital in control over the cooperative undertaking and in ownership of the financial benefits from ownership; (2) democratic control by the members of the cooperative; (3) vesting in and allocation among the members of all excess of operating revenues over the expenses incurred to generate revenues in proportion to their participation in the cooperative (patronage); and (4) operation at cost (not operating for profit or below cost). Regarding the requirement of democratic control, the IRS has stated that the election of officers must be on a one member, one vote basis.[48]

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[44] In general, the cooperative tax rules of subchapter T (sections 1381-1388 of the Code) apply to any corporation operating on a cooperative basis (except mutual savings banks, insurance companies, certain tax exempt organizations (such as those described in section 501(c)(12)), and certain utilities), including tax-exempt farmers' cooperatives (described in section 521(b)). Except for section 521 tax-exempt farmers' cooperatives, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative. Sec. 1382. The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative. Unlike subchapter T cooperatives, a section 501(c)(12) mutual or cooperative organization generally is exempt from Federal income tax, but pays tax on certain income derived from trade or business activities unrelated to the organization's exempt purposes (unrelated business taxable income, or UBTI).

[45] Sec. 501(c)(12)(A).

[46] See secs. 501(c)(12)(B)-(H).

[47] See Rev. Rul. 72-36, 1972-1 C.B. 151.

[48] See, *e.g.*, I.R.M. sec. 7.25.12.5 (Rev. August 9, 2006) (*citing Puget Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305 (1966), *acq*., 1966-2 C.B. 6).

Description of Proposal

The proposal provides that certain income received or accrued by a mutual ditch or irrigation company, or by a like organization to a mutual ditch or irrigation company, generally is not taken into account for purposes of applying the 85-percent-of-member-income test. This includes income received or accrued from: (1) the sale, lease, or exchange of fee or other interest in real property, including interests in water; (2) the sale or exchange of stock in a mutual ditch or irrigation company (or a like organization to a mutual ditch or irrigation company) or contract rights for the delivery or use of water; or (3) the investment of proceeds from sales, leases, or exchanges under (1) or (2).

Notwithstanding this general rule, any such income that is distributed or expended for expenses (other than for operations, maintenance, and capital improvements) of the mutual ditch or irrigation company or like organization is treated as non-member income for purposes of the 85-percent test in the year in which it is distributed or expended. For this purpose, "expenses (other than for operations, maintenance, and capital improvements)" include expenses for the construction of conveyances designed to deliver water outside of the mutual ditch or irrigation company or like organization system.

The proposal also provides a special rule for mutual ditch or irrigation companies (and like organizations to mutual ditch or irrigation companies) regarding organization governance. Under this special rule, where State law provides that such a company or organization may be organized in a manner that permits voting on a basis that is pro rata to share ownership on corporate governance matters, an organization's qualification as a mutual ditch or irrigation company (or a like organization to a mutual ditch or irrigation company) is determined without taking into account whether its member shareholders have one vote on corporate governance matters per share held in the corporation. This portion of the proposal, however, shall not be construed as giving rise to an inference regarding the requirements for organizations other than mutual ditch or irrigation companies (or like organizations to mutual ditch or irrigation companies).

Effective Date

The proposal is effective for taxable years beginning after the date of enactment.