Calendar No. 366

113TH CONGRESS *2d Session*	SENATE	REPORT 113–154

EXPIRING PROVISIONS IMPROVEMENT REFORM AND EFFICIENCY (EXPIRE) ACT OF 2014

R E P O R T

[TO ACCOMPANY S. 2260]

TO AMEND THE INTERNAL REVENUE CODE OF 1986 TO EXTEND CERTAIN EXPIRING PROVISIONS, AND FOR OTHER PURPOSES

COMMITTEE ON FINANCE
UNITED STATES SENATE

APRIL 28, 2014.—Ordered to be printed

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

R E P O R T

[To accompany S. 2260]

The Committee on Finance, having considered an original bill, S. 2260, to amend the Internal Revenue Code of 1986 to extend certain expiring provisions, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

I. LEGISLATIVE BACKGROUND

The Committee on Finance, having considered S. ______, the "Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014," to amend the Internal Revenue Code of 1986 to extend certain expiring provisions for the last time and provide taxpayers two years of certainty about their tax bills while building a bridge to tax reform, reports favorably thereon and recommends that the bill do pass.

Background and need for legislative action

In the late 1970s and early 1980s, Congress began the practice of enacting temporary tax incentives, either because they were unproven and it was appropriate to establish a schedule to review their effectiveness, or because the incentives were intended only to provide a "jump start" for a new industry. For example, in 1981, Congress first enacted the research and development tax credit and set it to expire at the end of 1985. Similarly, in 1978, Congress created credits for the installation of residential renewable energy equipment set to expire at the end of 1985.

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As time went on, the practice of enacting temporary tax provisions became more common. Under budgetary "scorekeeping" conventions, temporary provisions lost less revenue than permanent provisions. As a result, temporary provisions became an attractive way to enact changes to the tax laws while masquerading the actual revenue loss of the change. The number of expiring provisions that had to be extended rose dramatically. After the Tax Reform Act of 1986 was enacted, there were 14 tax provisions that were scheduled to expire. By 2012, there were 142. As a result, the Committees on Finance and Ways and Means have devoted an increasing share of their time and attention to legislation extending most or all of the expired and expiring provisions.

Along with the growth of the number of extenders the understanding of the adverse impact of temporary provisions has also grown. There are at least three perceived problems. First, the extension of tax provisions for short periods creates uncertainty because taxpayers cannot plan their affairs with a clear understanding of whether relevant tax provisions will be maintained. Second, the consideration of extenders bills had become an "all-or-nothing" process, with the extenders being considered as a single package, effectively foreclosing any analysis of the individual provisions' effectiveness or whether they merit continuation. Third, the multi-decade practice of renewing these provisions for short periods, often without offsets, implies permanent policy while masking the prohibitive cost of permanence. Making the provisions that expired in 2013 or are schedule to expire over the next decade permanent is projected to cost nearly $1 trillion though 2024.[1]

Something had to change.—In 2012, faced with many expired or soon to expire provisions there was a strong member consensus that each extender should be reviewed with some level of individual attention rather than extended as a single package. To this end, in 2011–12, the Finance and Ways and Means Committees each held hearings to review the expired and expiring provisions. In speeches Chairmen Baucus and Camp each said that extenders should be reviewed based on the merits. On August 2, 2012, the Committee on Finance favorably reported an extenders bill that actually allowed a number of provisions to expire. A similar set of provisions was later enacted in Titles II, III, and IV of the American Taxpayer Relief Act of 2012.

The need for tax reform spurred the Finance Committee to hold an extensive series of hearings from 2010 through 2012. The Finance Committee also published tax reform options papers in spring and summer of 2013. The Majority Staff published several tax reform discussion drafts in the fall of 2013. On a parallel track, Chairman Camp of the House Ways and Means Committee released a comprehensive tax reform draft on February 26, 2014. Finally, Chairman Wyden stated that based on the years he spent developing a bipartisan federal income tax reform plan, he believes the Senate can settle the extenders question on a bipartisan basis and then pursue tax reform.

In early 2014, Finance Committee Members acknowledged that a bipartisan plan on comprehensive tax reform legislation would

[1] Congressional Budget Office, "The Budget and Economic Outlook 2014 to 2024," Table 1–5.

still take time to reach. In the meantime, temporary provisions of the tax law continue to expire, leaving jobs, innovation and research, and people's homes in limbo. Instead, Finance Committee members agreed on the need to deliver two years of tax certainty and predictability in support of businesses and job creation, veterans, families, homeowners, and students by favorably reporting an extenders bill. Chairman Wyden intended that this fifteenth congressional effort at renewing the extenders be the final one, saying that "I want to be straightforward on one point—this will be the last tax extenders bill the committee takes up as long as I'm chairman. That's why the bill is called the EXPIRE Act. It is meant to expire." During the Committee's business meeting, several members of the Committee expressed similar views that the EXPIRE Act should be the last extenders bill.

Overview.—The EXPIRE Act of 2014 is intended to be a bridge to tax reform. As a result, the focus is on temporarily extending provisions that enjoyed broad bipartisan support as-is while improving other provisions that lawmakers felt had merit but required updating to continue functioning as productive economic incentives. The focus was decidedly not on reconsidering the merits of each individual temporary provision, a job that will be undertaken in comprehensive tax reform. The scope of the business meeting was limited to extending provisions in the tax code that expired in 2013 or will expire in 2014 through December 31, 2015, for a total of 55 provisions.

At the conclusion of the business meeting, with a majority and a quorum present, the Committee favorably reported the EXPIRE Act of 2014, as amended, by voice vote.

Individuals and Families.—The EXPIRE Act of 2014 continues key provisions that provide tax relief to individuals and families. One such provision extends mortgage debt relief for families that have benefited from mortgage loan modifications by providing that any cancelled mortgage debt does not become includible in gross income. The EXPIRE Act of 2014 provides tax relief by extending the above-the-line deduction for qualified higher education expenses and the deduction for general state and local sales taxes. The EXPIRE Act also extends the above-the-line deduction for teachers of up to $250 in qualified educational expenses. Finally, the bill extends the $250 monthly exclusion for employer-provided transit and vanpool benefits, continuing important parity with the exclusion for employer-provided parking benefits and allows individuals to exclude up to $20 per month of expenses associated with the use of a bike-sharing program.

Business Investment.—The EXPIRE Act of 2014 continues and expands tax incentives for research and experimentation to maintain U.S. global competitiveness, by extending the research and experimentation credit. The bill expands the R&E credit to start-up businesses (companies less than five years old with less than $5 million in gross receipts) which will be able to claim up to $250,000 per year of the credit against their payroll tax liability (after first applying the credit to any income tax liability). The EXPIRE Act of 2014 allows the R&E credit to count against AMT liability. Recognizing that continued business investment will help sustain the economic recovery, the bill extends the higher section 179 small business expensing limit and phase-out threshold ($500,000 and $2 million respectively) and indexes these amounts to inflation beginning in 2014. The bill also extends the first-year 50 percent bonus depreciation to qualified property and the placed in service dates. Finally, the EXPIRE Act of 2014 extends the look-through treatment of payments between related controlled foreign corporations.

Community Investment.—The EXPIRE Act of 2014 continues and modifies provisions designed to help certain communities and workers. For example, the Act extends the Health Coverage Tax Credit, which helps cover the cost of health care for dislocated individuals eligible for trade adjustment assistance or who are over 55 and receive pension benefits from the Pension Benefit Guaranty Corporation. The bill extends the Work Opportunity Tax Credit, which provides a wage credit to employers that hire veterans and recipients of Temporary Assistance for Needy Families, and expands the credit to individuals who have exhausted their 26 weeks of regular unemployment benefits. The employer wage credit for active military reservists, which helps defray the cost of wages paid to employees on active duty, is expanded to allow all businesses regardless of size to claim the credit, and the credit is boosted from 20% to 100% of up to $20,000 of differential pay. The EXPIRE Act of 2014 extends the Qualified Zone Academy Bond program that helps certain school districts finance the modernization of public school facilities, and increases the tax credit bond's potential utilization by reducing the private sector match requirement that has limited bond issuance. The bill extends Empowerment Zones, which offer an array of tax incentives to businesses to hire and invest in economically distressed communities. The bill adds a new category of allocations to the New Markets Tax Credit for manufacturing investments in communities that have experienced a major job loss event. Finally, a modification to the Low-Income Housing Tax Credit Program establishes a 4% minimum credit rate for the acquisition of existing housing that is not federally subsidized.

Energy Efficiency and Investment.—The EXPIRE Act of 2014 extends, improves and expands a dozen tax incentives that promote energy efficiency or the production and use of renewable or alternative energy. The goals of these provisions are to make the current incentives more effective, maintain renewable and alternative energy jobs, and further the U.S. global competitive position in the development of renewable and alternative energy technology. In particular, the bill extends the section 45 and 48 incentives for energy property used in the production of wind and other renewable sources of electricity. The bill modifies the section 179D deduction for energy efficient commercial building property, raising the qualifying efficiency standards and allowing tribal governments and non-profits to allocate the deduction to designers. The bill amends and expands the credit for energy efficient improvements to existing homes. The Act also extends incentives that promote the use of alternative fuels. The EXPIRE Act of 2014 does not extend the section 45M credit for energy efficiency appliances as well as the placed-in-service date for partial expensing of certain refinery property.

Offsets.—Revenue-raising provisions were included to fully offset modifications that increased the revenue loss of provisions relative to current policy. Such provisions include requiring the Secretary of the Treasury to employ third-party tax collectors to aid in tax collection, increasing levy authority on payments to Medicare providers with delinquent tax debts, and applying paid preparer Earned Income Tax Credit due diligence requirements to the child tax credit.

II. EXPLANATION OF THE BILL

A. SENSE OF THE SENATE

(Sec. 2 of the bill)

The bill expresses the sense of the Senate that a process of comprehensive tax reform should commence in the 114th Congress and conclude before January 1, 2016; that Congress should endeavor, as part of such a tax reform process, to eliminate temporary provisions from the Internal Revenue Code of 1986 by making permanent those provisions that merit permanency and allowing others to expire; that a major focus of such tax reform process should be fostering economic growth and lowering tax rates by broadening the tax base; and that the Chairman and Ranking Member of the Committee on Finance of the Senate should consult with the Chairman and Ranking Member of the Committee on the Budget of the Senate to ensure that the appropriate baseline is used in determining the economic effects of, and rate adjustments under, tax reform.

TITLE I—PROVISIONS EXPIRING IN 2013

A. SUBTITLE A—INDIVIDUAL TAX EXTENDERS

1. Health coverage tax credit (sec. 101 of the bill and sec. 35 of the Code)

PRESENT LAW

In the case of an eligible individual, a refundable tax credit is provided for 72.5 percent of the individual's premiums for qualified health insurance of the individual and qualifying family members for each eligible coverage month beginning in the taxable year.[2] The credit is commonly referred to as the health coverage tax credit ("HCTC"). The credit is available only with respect to amounts paid by the individual for the qualified health insurance.

Eligibility for the credit is determined on a monthly basis. In general, an eligible coverage month is any month if (1) the month begins before January 1, 2014, and (2) as of the first day of the month, the individual is an eligible individual, is covered by qualified health insurance, the premium for which is paid by the individual, does not have other specified coverage, and is not imprisoned under Federal, State, or local authority. In the case of a joint return, the eligibility requirements are met if at least one spouse satisfies the requirements.

An eligible individual is an individual who is (1) an eligible Trade Adjustment Assistance ("TAA") recipient, (2) an eligible alternative TAA recipient, or (3) an eligible Pension Benefit Guar-

[2] Qualifying family members are the individual's spouse and any dependent for whom the individual is entitled to claim a dependency exemption. Any individual who has certain specified coverage is not a qualifying family member.

anty Corporation ("PBGC") pension recipient. In general, an individual is an eligible TAA recipient for a month if the individual (1) receives for any day of the month a trade readjustment allowance under the Trade Act of 1974 or would be eligible to receive such an allowance but for the requirement that the individual exhaust unemployment benefits before being eligible to receive an allowance and (2) with respect to such allowance, is covered under a required certification. An individual is an eligible alternative TAA recipient for a month if the individual participates in a certain program under the Trade Act of 1974 and receives a related benefit for the month. Generally, an individual is an eligible PBGC pension recipient for any month if the individual (1) is age 55 or over as of the first day of the month and (2) receives a benefit for the month, any portion of which is paid by the PBGC. A person who may be claimed as a dependent on another person's tax return is not an eligible individual. In addition, an otherwise eligible individual is not eligible for the credit for a month if, as of the first day of the month, the individual has certain specified coverage, such as certain employer-provided coverage or coverage under certain governmental health programs.

The credit is available on an advance payment basis by means of payments by the Department of the Treasury ("Treasury") once a qualified health insurance costs credit eligibility certificate is in effect.[3] In some cases, Treasury may also make retroactive payments on behalf of a certified individual for qualified health insurance coverage for eligible coverage months occurring before the first month for which an advance payment is otherwise made on behalf of the individual.

REASONS FOR CHANGE

The HCTC has played an important role in enabling individuals who receive a trade adjustment allowance, or whose pension is paid by the PBGC, to purchase health insurance coverage. The Committee wishes to continue providing this assistance to such individuals.

EXPLANATION OF PROVISION

The provision amends the definition of eligible coverage month for HCTC purposes to include months beginning before January 1, 2016 (rather than only months beginning before January 1, 2014 under present law), if the requirements for an eligible coverage month are otherwise met.

EFFECTIVE DATE

The provision is effective for coverage months beginning after December 31, 2013.

[3] Sec. 7527.

2. Extension of deduction for certain expenses of elementary and secondary school teachers (sec. 102 of the bill and sec. 62(a)(2)(D) of the Code)

PRESENT LAW

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. For taxable years beginning after 2012, an individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of a threshold amount. In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Certain expenses of eligible educators are allowed as an above-the-line deduction. Specifically, for taxable years beginning prior to January 1, 2014, an above-the-line deduction is allowed for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom.[4] To be eligible for this deduction, the expenses must be otherwise deductible under section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under section 135 (relating to education savings bonds), 529(c)(1) (relating to qualified tuition programs), and section 530(d)(2) (relating to Coverdell education savings accounts).

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

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2013.

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

The provision extends the deduction for eligible educator expenses for two years, through December 31, 2015.

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

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2013.

3. Extension of exclusion from gross income of discharges of acquisition indebtedness on principal residences (sec. 103 of the bill and sec. 108 of the Code)

PRESENT LAW

In general

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108).[5] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge (sec. 1017).

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

Qualified principal residence indebtedness

An exclusion from gross income is provided for any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B), except that the dollar limitation is $2 million) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. For these purposes, the term "principal residence" has the same meaning as under section 121 of the Code.

[5] A debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor (sec. 102).

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of $1 million, of which $800,000 is qualified principal residence indebtedness. If the residence is sold for $700,000 and $300,000 debt is discharged, then only $100,000 of the amount discharged may be excluded from gross income under the qualified principal residence indebtedness exclusion.

The basis of the individual's principal residence is reduced by the amount excluded from income under the provision.

The qualified principal residence indebtedness exclusion does not apply to a taxpayer in a Title 11 case; instead the general exclusion rules apply. In the case of an insolvent taxpayer not in a Title 11 case, the qualified principal residence indebtedness exclusion applies unless the taxpayer elects to have the general exclusion rules apply instead.

The exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

The exclusion for qualified principal residence indebtedness is effective for discharges of indebtedness before January 1, 2014.

REASONS FOR CHANGE

The Committee believes the provision should be extended because taxpayers restructuring their acquisition debt on a principal residence or losing their principal residence in a foreclosure, are also likely, due to their economic circumstances, to lack the necessary liquidity to pay taxes on the resulting discharged debt, were it to be included in gross income.

EXPLANATION OF PROVISION

The provision extends for two additional years (through December 31, 2015) the exclusion from gross income for discharges of qualified principal residence indebtedness.

EFFECTIVE DATE

The provision applies to discharges of indebtedness on or after January 1, 2014.

4. Parity for exclusion from income for employer-provided mass transit and parking benefits (sec. 104 of the bill and 132(f) of the Code)

PRESENT LAW

Qualified transportation fringes

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income for income tax purposes and from an employee's wages for employment tax purposes.[6] Qualified transportation fringe benefits include parking, transit

[6] Secs. 132(a)(5) and (f), 3121(a)(20), 3231(e)(5), 3306(b)(16) and 3401(a)(19).

passes, vanpool benefits, and qualified bicycle commuting reimbursements. No amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits (other than a qualified bicycle commuting reimbursement). Qualified transportation fringe benefits also include a cash reimbursement (under a bona fide reimbursement arrangement) by an employer to an employee for parking, transit passes, or vanpooling. In the case of transit passes, however, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item that may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

Mass transit parity

Before February 17, 2009, the amount that could be excluded as qualified transportation fringe benefits was limited to $100 per month in combined transit pass and vanpool benefits and $175 per month in qualified parking benefits. These limits are adjusted annually for inflation, using 1998 as the base year; for 2014, the limits are $130 and $250, respectively. Effective for months beginning on or after February 17, 2009,[7] and before January 1, 2014, parity in qualified transportation fringe benefits is provided by temporarily increasing the monthly exclusion for combined employer-provided transit pass and vanpool benefits to the same level as the exclusion for employer-provided parking.

Effective January 1, 2014, the amount that can be excluded as qualified transportation fringe benefits is limited to $130 per month in combined transit pass and vanpool benefits and $250 per month in qualified parking benefits.

Qualified bicycle commuting reimbursements

Qualified bicycle commuting reimbursements with respect to a calendar year are limited to employer reimbursements during the 15 month period beginning on the first day of the calendar year for expenses incurred during the calendar year for the purchase of a bicycle and bicycle improvements, repairs and storage, by an employee who regularly uses the bicycle for commuting. For this purpose, commuting means to use the bicycle for a substantial portion of the travel between the employee's residence and place of employment. In the case of qualified bicycle commuting reimbursements, the amount that can be excluded for a taxable year is limited to $20 multiplied by the number of months during the year that the employee regularly uses the bicycle for commuting and does not receive another qualified transportation fringe benefit.

REASONS FOR CHANGE

Maintaining parity between parking and mass transit benefits provides employees with an incentive to use public transportation and vanpools for their commute rather than driving to work in their personal vehicles, thus potentially easing traffic congestion and pollution.

[7] Parity was originally provided by the American Recovery and Reinvestment Act of 2009 ("ARRA"), Pub. L. No. 111–5, effective for months beginning on or after February 17, 2009, the date of enactment of ARRA.

Some employees who regularly commute to work by bicycle do not use their own bicycles but use bicycles available through a bicycle-share program. The Committee believes that reimbursement from employers for an employee's use of a bicycle-share program for commuting to work should be accorded the same tax treatment as reimbursement for the cost of purchase and maintenance by an employee of his or her own bicycle used for commuting.

EXPLANATION OF PROVISION

Mass transit parity

The provision extends parity in the exclusion for combined employer-provided transit pass and vanpool benefits and for employer-provided parking benefits for two years through December 31, 2015. Thus, for 2014, the monthly limit on the exclusion for combined transit pass and vanpool benefits is $250, the same as the monthly limit on the exclusion for qualified parking benefits.

In order for the extension to be effective retroactive to January 1, 2014, expenses incurred for months beginning after December 31, 2013, and before enactment of the provision, by an employee for employer-provided vanpool and transit benefits may be reimbursed (under a bona fide reimbursement arrangement) by employers on a tax-free basis to the extent they exceed $130 per month and are no more than $250 per month. The Committee intends that the rule that an employer reimbursement is excludible only if vouchers are not available to provide the benefit continues to apply, except in the case of reimbursements for vanpool or transit benefits between $130 and $250 for months beginning after December 31, 2013, and before enactment of the provision. Further, the Committee intends that reimbursements for expenses incurred for months beginning after December 31, 2013, and before enactment of the provision, may be made in addition to the provision of benefits or reimbursements of up to $250 per month for expenses incurred for months beginning during 2014 and after enactment of the provision.

Qualified bicycle commuting reimbursements

Under the provision, an employer reimbursement of the expense of a bicycle-share program for an employee who regularly uses the program for commuting qualifies for exclusion from gross income (and wages for employment tax purposes) as a qualified bicycle commuting reimbursement, subject to the $20-per-month limit on this exclusion and provided the employee does not receive another qualified transportation fringe benefit for the month. This provision only applies to reimbursement for taxable years beginning before January 1, 2016.

EFFECTIVE DATE

The provision relating to parity in the exclusion for combined employer-provided transit pass and vanpool benefits and for employer-provided parking benefits applies to months after December 31, 2013. The provision related to qualified bicycle commuting reimbursements is effective for taxable years beginning after December 31, 2013.

5. Extension of mortgage insurance premiums treated as qualified residence interest (sec. 105 of the bill and sec. 163 of the Code)

PRESENT LAW

In general

Present law provides that qualified residence interest is deductible notwithstanding the general rule that personal interest is nondeductible.[8]

Acquisition indebtedness and home equity indebtedness

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is $100,000. The maximum amount of acquisition indebtedness is $1 million. Acquisition indebtedness means debt that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

Private mortgage insurance

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of married individual filing a separate return).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and private mortgage insurance (defined in section two of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Service).

The provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates for any amount paid or accrued after December 31, 2013, or properly allocable to any period after that date.

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[8] Sec. 163(h).

Reporting rules apply under the provision.

REASONS FOR CHANGE

The Committee believes it is appropriate to extend the present-law temporary provision. The Committee understands that the purpose of the provisions permitting deduction of home mortgage interest is to encourage home ownership while limiting significant disincentives to saving. The Committee believes that it would be consistent with the purpose of the provisions permitting deduction of home mortgage interest to permit the deduction of mortgage insurance premiums. While these premiums are not in the nature of interest, the Committee notes that purchase of such insurance is often demanded by lenders in order for home buyers to obtain financing (depending on the size of the buyer's down payment). The Committee believes that permitting deductibility of premiums for this type of insurance connected with home purchases will foster home ownership. In the case of higher income taxpayers who may not purchase mortgage insurance, however, the Committee believes the incentive of deductibility becomes unnecessary, and a phase-out is appropriate. It is not intended that prepayments be currently deductible, but rather, that they be deductible only in the period to which they relate. Reporting of payments is generally necessary to administer the provision.

EXPLANATION OF PROVISION

The provision extends the deduction for private mortgage insurance premiums for two years (with respect to contracts entered into after December 31, 2006). Thus, the provision applies to amounts paid or accrued in 2014 and 2015 (and not properly allocable to any period after 2015).

EFFECTIVE DATE

The provision applies to amounts paid or accrued after December 31, 2013.

6. Extension of deduction for State and local general sales taxes (sec. 106 of the bill and sec. 164 of the Code)

PRESENT LAW

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning before 2014, at the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes. As is the case for State and local income taxes, the itemized deduction for State and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account number of dependents, modified adjusted gross income and rates of State and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. Taxpayers who use the tables created by the Secretary may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats, and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

A general sales tax is a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items.[9] No deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of food, clothing, medical supplies, and motor vehicles, the above rules are relaxed in two ways. First, if the tax does not apply with respect to some or all of such items, a tax that applies to other such items can still be considered a general sales tax. Second, the rate of tax applicable with respect to some or all of these items may be lower than the general rate. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess is disregarded and the general rate is treated as the rate of tax.

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

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

The provision extends the provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes for two years, through 2015.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2013.

[9] Sec. 164(b)(5)(B).

7. Extension of special rule for contributions of capital gain real property made for conservation purposes (sec. 107 of the bill and sec. 170(b) of the Code)

PRESENT LAW

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[10]

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks. Total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations generally may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to most private nonoperating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions in excess of the applicable percentage limits generally may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

Capital gain property

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

[10] Secs. 170, 2055, and 2522, respectively.

erating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

Qualified conservation contributions

Qualified conservation contributions are one exception to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property.[11] A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

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

Temporary rules regarding contributions of capital gain real property for conservation purposes

In general

Under a temporary provision[12] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

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

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is

[11] Secs. 170(f)(3)(B)(iii) and 170(h).
[12] Sec. 170(b)(1)(E).

allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carry over the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and ranchers

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

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

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

As an additional condition of eligibility for the 100 percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.)

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

Termination

The temporary rules regarding contributions of capital gain real property for conservation purposes do not apply to contributions made in taxable years beginning after December 31, 2013.[14]

REASONS FOR CHANGE

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

[13] Sec. 170(b)(2)(B).
[14] Secs. 170(b)(1)(E)(vi) and 170(b)(2)(B)(iii).

EXPLANATION OF PROVISION

The provision extends the increased percentage limits and extended carryforward period for contributions of capital gain real property for conservation purposes for two additional years, i.e., for contributions made in taxable years beginning before January 1, 2016.

EFFECTIVE DATE

The provision is effective for contributions made in taxable years beginning after December 31, 2013.

8. Deduction for qualified tuition and related expenses (sec. 108 of the bill and sec. 222 of the Code)

PRESENT LAW

An individual is allowed a deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[15] The deduction is allowed in computing adjusted gross income. The term qualified tuition and related expenses is defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution.[16] The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2013.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual,[17] and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition and

[15] Sec. 222.

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

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

fees; and (2) income from a Coverdell education savings account.[18] Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion under section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

The provision extends the qualified tuition deduction for two years, through 2015.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2013.

9. Extension of tax-free distributions from individual retirement plans for charitable purposes (sec. 109 of the bill and sec. 408(d)(8) of the Code)

PRESENT LAW

In general

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

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to the following entities: (1) a charity described in section 170(c)(2); (2) certain veterans’ organizations, fraternal societies, and cemetery companies;[19] and (3) a Federal, State, or local governmental entity, but only if the contribution is made for exclusively public purposes.[20] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

[18] Sec. 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.
[19] Secs. 170(c)(3)–(5).
[20] Sec. 170(c)(1).

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[21]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[22]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service provided) to the taxpayer in consideration for the contribution.[23] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[24]

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

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

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in prop-

[21] Secs. 170(b) and (e).
[22] Sec. 170(a).
[23] Sec. 170(f)(8). For any contribution of a cash, check, or other monetary gift, no deduction is allowed unless the donor maintains as a record of such contribution a bank record or written communication from the donee charity showing the name of the donee organization, the date of the contribution, and the amount of the contribution. Sec. 170(f)(17).
[24] Sec. 6115.

erty to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[25] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[26] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Certain individuals also may make nondeductible contributions to a Roth IRA (deductible contributions cannot be made to Roth IRAs). Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59-½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by April 1 of the calendar year following the year in which the IRA owner attains age 70-½.[27]

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

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[28] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as

[25] Secs. 170(f), 2055(e)(2), and 2522(c)(2).
[26] Sec. 170(f)(2).
[27] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.
[28] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

a single contribution, and all conversion contributions during the year are treated as a single contribution.

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[29] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

Qualified charitable distributions

Otherwise taxable IRA distributions from a traditional or Roth IRA are excluded from gross income to the extent they are qualified charitable distributions.[30] The exclusion may not exceed $100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. A qualified charitable distribution is taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA as a result of qualified charitable distributions being made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (other than an organization described in section 509(a)(3) or a donor advised fund (as defined in section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70-½ and only to the extent the distribution would be includible in gross income (without regard to this provision).

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

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

[29] Sec. 3405.

[30] Sec. 408(d)(8). The exclusion does not apply to distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions (“SEPs”).

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

Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2013.

REASONS FOR CHANGE

The Committee believes that facilitating charitable contributions from IRAs will increase giving to charitable organizations. Therefore, the Committee believes that the exclusion for qualified charitable distributions should be extended for two years.

EXPLANATION OF PROVISION

The provision extends the exclusion from gross income for qualified charitable distributions from an IRA for two additional years, i.e., for distributions made in taxable years beginning before January 1, 2016.

EFFECTIVE DATE

The provision is effective for distributions made in taxable years beginning after December 31, 2013.

B. Subtitle B—Business Tax Extenders

1. Extension and modification of research credit (sec. 111 of the bill and secs. 38 and 41 and new sec. 3111(f) of the Code)

PRESENT LAW

Research credit

General rule

For general research expenditures, a taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.[31] Thus, the research credit is generally available with respect to incremental increases in qualified research. An alternative simplified research credit (with a 14 percent rate and a different base amount) may be claimed in lieu of this credit.[32]

A 20-percent research tax credit also is available with respect to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.[33] This sepa-

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[31] Sec. 41(a)(1).

[32] Sec. 41(c)(5).

[33] Sec. 41(a)(2). The base period for the basic research credit generally extends from 1981 through 1983.

rate credit computation commonly is referred to as the basic research credit.[34]

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium.[35] This separate credit computation commonly is referred to as the energy research credit. Unlike the other research credits, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit, including the basic research credit and the energy research credit, expires for amounts paid or incurred after December 31, 2013.[36]

Computation of general research credit

The general research tax credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. In general, the base amount for the current year generally is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). Special rules apply to all other taxpayers (so called start-up firms).[37] In computing the research credit, a taxpayer's base amount cannot be less than 50 percent of its current-year qualified research expenses.

Alternative simplified credit

The alternative simplified research credit is equal to 14 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years.[38] The rate is reduced to six percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.[39] An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary.[40]

[34] Sec. 41(e).
[35] Sec. 41(a)(3).
[36] Sec. 41(h).
[37] The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).
[38] Sec. 41(c)(5)(A).
[39] Sec. 41(c)(5)(B).
[40] Sec. 41(c)(5)(C).

Eligible expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called contract research expenses).[41] Notwithstanding the limitation for contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or Federal laboratory for qualified energy research.

To be eligible for the credit, the research not only has to satisfy the requirements of section 174, but also must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors.[42] In addition, research does not qualify for the credit if: (1) conducted after the beginning of commercial production of the business component; (2) related to the adaptation of an existing business component to a particular customer's requirements; (3) related to the duplication of an existing business component from a physical examination of the component itself or certain other information; (4) related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control; (5) related to software developed primarily for internal use by the taxpayer; (6) conducted outside the United States, Puerto Rico, or any U.S. possession; (7) in the social sciences, arts, or humanities; or (8) funded by any grant, contract, or otherwise by another person (or government entity).[43]

Relation to deduction

Deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.[44] Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.[45]

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[41] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. Sec. 41(b)(3)(C).

[42] Sec. 41(d)(3).

[43] Sec. 41(d)(4).

[44] Sec. 280C(c).

[45] Sec. 280C(c)(3).

FICA taxes

The Federal Insurance Contributions Act ("FICA") imposes tax on employers and employees based on the amount of wages (as defined for FICA purposes) paid to an employee during the year, often referred to as "payroll" taxes.[46] The tax imposed on the employer and on the employee is each composed of two parts: (1) the Social Security or old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base ($117,000 for 2014); and (2) the Medicare or hospital insurance ("HI") tax equal to 1.45 percent of all covered wages.[47] The employee portion of the FICA tax generally must be withheld and remitted to the Federal government by the employer.

An employer generally files quarterly employment tax returns showing its liability for FICA taxes with respect to its employees' wages for the quarter, as well as the employee FICA taxes and income taxes withheld from the employees' wages.

General business credit

For any taxable year, the general business credit (which is the sum of the various business credits) generally may not exceed the excess of the taxpayer's net income tax[48] over the greater of (1) the taxpayer's tentative minimum tax or (2) 25 percent of so much of the taxpayer's net regular tax liability[49] as exceeds $25,000.[50] Any general business credit in excess of this limitation may be carried back one year and forward up to 20 years.[51] The tentative minimum tax is an amount equal to specified rates of tax imposed on the excess of the alternative minimum taxable income over an exemption amount.[52]

In applying the tax liability limitation to certain credits ("specified credits") that are part of the general business credit, the tentative minimum tax is treated as being zero.[53] Thus, specified credits may offset both regular tax and alternative minimum tax ("AMT") liabilities.

Eligible small businesses for 2010 were allowed to offset both regular tax and AMT liabilities with their eligible small business credits.[54] For this purpose, eligible small business credits were defined as the sum of the general business credits determined for the taxable year with respect to an eligible small business.[55] An eligible small business was, with respect to any taxable year, a corporation, the stock of which was not publicly traded, or a partnership, which met the gross receipts test of section 448(c), substituting $50

[46] Secs. 3101–3128.

[47] Beginning 2013, the employee portion of the HI tax under FICA (not the employer portion) is increased by an additional tax of 0.9 percent on wages received in excess of a threshold amount. The threshold amount is $250,000 in the case of a joint return, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

[48] The term "net income tax" means the sum of the regular tax liability and the tax imposed by section 55, reduced by the credits allowable under subparts A and B of this part. Sec. 38(c)(1).

[49] The term "net regular tax liability" means the regular tax liability reduced by the sum of credits allowable under subparts A and B of this part. Sec. 38(c)(1).

[50] Sec. 38(c)(1).

[51] Sec. 39(a)(1).

[52] See sec. 55(b).

[53] See section 38(c)(4)(B) for the list of specified credits, which does not presently include the research credit determined under section 41.

[54] Sec. 38(c)(5).

[55] Sec. 38(c)(5)(B).

million for $5 million each place it appears.[56] In the case of a sole proprietorship, the gross receipts test was applied as if it were a corporation. Credits determined with respect to a partnership or S corporation were not treated as eligible small business credits by a partner or shareholder unless the partner or shareholder met the gross receipts test for the taxable year in which the credits were treated as current year business credits.[57]

REASONS FOR CHANGE

The Committee acknowledges that research is important to the economy. Research is the basis of new products, new services, new industries, and new jobs. There can be cases where an individual business may not find it profitable to invest in research as much as it otherwise might because it is difficult to capture the full benefits from the research and prevent such benefits from being used by competitors. At the same time, research may create great benefits that spill over to society at large. To encourage activities that will result in these spillover benefits to society at large, the government acts to promote research in a variety of ways, including granting patents and direct funding of research. Another way for the government to promote research is through tax incentives such as the research credit. The Committee therefore believes it is appropriate to extend the present-law research credit.

In addition, the Committee wants to help small businesses have better access to and be able to benefit from the research credit. In some cases, a small business may not have sufficient income tax liability for a particular year against which to apply the credit. In that case, the Committee believes it is appropriate to allow a limited amount of a taxpayer's research credit to be claimed against its payroll tax liability. The Committee also believes that in the case of small businesses it is appropriate to allow the research credit to be claimed against the AMT.[58]

EXPLANATION OF PROVISION

Research credit

The provision extends the present law credit for two years, for qualified research expenses paid or incurred before January 1, 2016.

Payroll tax credit

In general

Under the provision, a qualified small business may elect for any taxable year to claim a certain amount of its research credit as a payroll tax credit against its employer OASDI liability, rather than

[56] Sec. 38(c)(5)(C).

[57] Sec. 38(c)(5)(D).

[58] See secs. 38 and 39. For example, assume a taxpayer is subject to AMT of $100,000 and regular tax of $80,000, and calculates a research credit of $90,000 for the taxable year at issue (assuming no other general business credits). Under present law, the taxpayer's research credit would be limited to the excess of $100,000 over the greater of (1) $100,000 or (2) $13,750 (25% of the excess of $80,000 over $25,000). Accordingly, no research credit may be claimed ($100,000 − $100,000 = $0). As a result, the taxpayer would owe $100,000 of tax and carry back or forward its $90,000 research credit, as applicable.

against its income tax liability.[59] A qualified small business is defined, with respect to any taxable year, as a corporation (including an S corporation) or partnership (1) with gross receipts of less than $5 million for the taxable year[60] and (2) that did not have gross receipts for any taxable year before the five taxable year period ending with the taxable year. An individual carrying on one or more trades or businesses also may be considered a qualified small business if the individual meets the conditions set forth in (1) and (2), taking into account its aggregate gross receipts received with respect to all trades or businesses. A qualified small business does not include an organization exempt from income tax under section 501.

The payroll tax credit portion is the least of (1) an amount specified by the taxpayer that does not exceed $250,000, (2) the research credit determined for the taxable year, or (3) in the case of a qualified small business other than a partnership or S corporation, the amount of the business credit carryforward under section 39 from the taxable year (determined before the application of this provision to the taxable year).

For purposes of this provision, all members of the same controlled group or group under common control are treated as a single taxpayer.[61] The $250,000 amount is allocated among the members in proportion to each member's expenses on which the research credit is based. Each member may separately elect the payroll tax credit, but not in excess of its allocated dollar amount.

A taxpayer may make an annual election under this section, specifying the amount of its research credit not to exceed $250,000 that may be used as a payroll tax credit, on or before the due date (including extensions) of its originally filed return.[62] A taxpayer may not make an election for a taxable year if it has made such an election for five or more preceding taxable years. An election to apply the research credit against OASDI liability may not be revoked without the consent of the Secretary of the Treasury ("Secretary"). In the case of a partnership or S corporation, an election to apply the credit against its OASDI liability is made at the entity level.

Application of credit against OASDI tax liability

The payroll tax portion of the research credit is allowed as a credit against the qualified small business's OASDI tax liability for the first calendar quarter beginning after the date on which the qualified small business files its income tax or information return for the taxable year. The credit may not exceed the OASDI tax liability for a calendar quarter on the wages paid with respect to all employees of the qualified small business.

If the payroll tax portion of the credit exceeds the qualified small business's OASDI tax liability for a calendar quarter, the excess is

[59] The credit does not apply against its employer HI liability or against the employee's FICA taxes the employer is required to withhold and remit to the government.

[60] For this purpose, gross receipts are determined under the rules of section 448(c)(3), without regard to subparagraph (A) thereof.

[61] For this purpose, all persons or entities treated as a single taxpayer under section 41(f)(1) are treated as a single person for purposes of this section.

[62] In the case of a qualified small business that is a partnership, the return required to be filed under section 6031. In the case of a qualified small business that is an S corporation, the return required to be filed under section 6037. In the case of any other qualified small business, the return of tax for the taxable year.

allowed as a credit against the OASDI liability for the following calendar quarter.

Other rules

The Secretary is directed to prescribe such regulations as are necessary to carry out the purposes of the provision, including (1) to prevent the avoidance of the purposes of the limitations and aggregation rules through the use of successor companies or other means, (2) to minimize compliance and record-keeping burdens, and (3) for recapture of the credit amount applied against OASDI taxes in the case of an adjustment to the payroll tax portion of the research credit, including requiring amended returns in such a case.

General business credit

In the case of an eligible small business (as defined in the provision relating to eligible small business credits for 2010), the research credit determined under section 41 for taxable years beginning after December 31, 2013 is a specified credit. Thus, these research credits of an eligible small business may offset both regular tax and AMT liabilities.[63]

EFFECTIVE DATE

The provision to extend the research credit for two years is effective for amounts paid or incurred after December 31, 2013. The provision to allow the research credit against FICA taxes is effective for credits determined for taxable years beginning after December 31, 2013. The provision to allow the research credit against AMT is effective for research credits of eligible small businesses determined for taxable years beginning after December 31, 2013, and to carrybacks of such credits.

2. Extension and modification of temporary minimum low-income housing tax credit rate for non-Federally subsidized buildings (sec. 112 of the bill and sec. 42 of the Code)

PRESENT LAW

In general

The low-income housing credit may be claimed over a 10-year credit period after each low-income building is placed-in-service. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building.

Present value credit

The calculation of the applicable percentage is designed to produce a credit equal to: (1) 70 percent of the present value of the building's qualified basis in the case of newly constructed or sub-

[63] Using the above example, under this provision, the limitation would be the excess of $80,000 over the greater of (1) $0 or (2) $13,750. Since $13,750 is greater than $0, the $80,000 would be reduced by $13,750 such that the research credit limitation would be $66,250. Hence, the taxpayer would be able to claim a research credit of $66,250 against its net income tax liability, as well as its AMT liability, which would result in $33,250 of total tax owed ($100,000 − $66,250). The remaining $23,750 of its research credit ($90,000 − $66,250) may be carried back or forward, as applicable.

stantially rehabilitated housing that is not Federally subsidized (the "70-percent credit"); or (2) 30 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is Federally subsidized and existing housing that is substantially rehabilitated (the "30-percent credit"). Where existing housing is substantially rehabilitated, the existing housing is eligible for the 30-percent credit and the qualified rehabilitation expenses (if not Federally subsidized) are eligible for the 70-percent credit.

Calculation of the applicable percentage

In general

The credit percentage for a low-income building is set for the earlier of: (1) the month the building is placed in service; or (2) at the election of the taxpayer, (a) the month the taxpayer and the housing credit agency enter into a binding agreement with respect to such building for a credit allocation, or (b) in the case of a tax-exempt bond-financed project for which no credit allocation is required, the month in which the tax-exempt bonds are issued.

These credit percentages (used for the 70-percent credit and 30-percent credit) are adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the Applicable Federal Rates for mid-term and long-term obligations for the month the building is placed in service. The discounting formula assumes that each credit is received on the last day of each year and that the present value is computed on the last day of the first year. In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.

Special rule

Under this rule the applicable percentage is set at a minimum of 9 percent for newly constructed non-Federally subsidized buildings placed in service after July 30, 2008, and before January 1, 2014.

REASONS FOR CHANGE

There is a critical shortage of affordable housing. Historically low Federal interest rates result in lower credit amounts for low-income housing tax credit properties. To reduce uncertainty and financial risk in the adjustable rate, the Committee believes that an extension of the temporary minimum percentage for newly constructed non-Federally subsidized buildings is warranted. Similarly, the Committee believes establishing a temporary minimum percentage for existing non-Federally subsidized buildings also is appropriate to increase the financial feasibility for the renovation and preservation of older properties.

EXPLANATION OF PROVISION

The provision extends the temporary minimum applicable percentage of 9 percent for newly constructed non-Federally subsidized buildings with respect to which credit allocations are made before January 1, 2016. The provision also establishes a 4-percent minimum credit rate for acquisition of existing housing that is not Federally subsidized. Any existing housing that is also financed with tax-exempt bonds is considered Federally subsidized for this purpose and therefore is not eligible for the 4-percent minimum credit rate. The 4-percent minimum credit rate applies to buildings placed in service after the date of enactment with respect to which credit allocations are made before January 1, 2016.

EFFECTIVE DATE

The provision is effective on January 1, 2014.

3. Extension of military housing allowance exclusion for determining area median gross income (sec. 113 of the bill and secs. 42 and 142 of the Code)

PRESENT LAW

In general

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). These income figures are adjusted for family size.

Rule for income determinations before July 30, 2008 and on or after January 1, 2014

The recipients of the military basic housing allowance must include these amounts for purposes of low-income credit eligibility income test, as described above.

Special rule for income determination before January 1, 2014

Under the provision the basic housing allowance (i.e., payments under 37 U.S.C. sec. 403) is not included in income for the low-income credit income eligibility rules. The provision is limited in application to qualified buildings. A qualified building is defined as any building located:

1. any county which contains a qualified military installation to which the number of members of the Armed Forces assigned to units based out of such qualified military installation has increased by 20 percent or more as of June 1, 2008, over the personnel level on December 31, 2005; and

2. any counties adjacent to a county described in (1), above.

For these purposes, a qualified military installation is any military installation or facility with at least 1000 members of the Armed Forces assigned to it.

The provision applies to income determinations: (1) made after July 30, 2008, and before January 1, 2014, in the case of qualified buildings which received credit allocations on or before July 30, 2008, or qualified buildings placed in service on or before July 30, 2008, to the extent a credit allocation was not required with respect to such building by reason of 42(h)(4) (*i.e.*, such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued before July 30, 2008; and (2) made after July 30, 2008, in the case of qualified buildings which received credit allocations after July 30, 2008 and before January 1, 2014, or qualified buildings placed in service after July 30, 2008, and before January 1, 2014, to the extent a credit allocation was not required with respect to such qualified building by reason of 42(h)(4) (*i.e.*, such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued after July 30, 2008, and before January 1, 2014.

REASONS FOR CHANGE

The Committee believes that encouraging owners of low-income housing credit properties to rent such subsidized units to military families is appropriate.

EXPLANATION OF PROVISION

The provision extends the special rule two additional years (through December 31, 2015).

EFFECTIVE DATE

The provision is effective as if included in the enactment of section 3005 of the Housing Assistance Tax Act of 2008.

4. Extension of Indian employment tax credit (sec. 114 of the bill and sec. 45A of the Code)

PRESENT LAW

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees.[64] The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An "Indian reservation" is a reservation as defined in sec-

[64] Sec. 45A.

tion 3(d) of the Indian Financing Act of 1974 [65] or section 4(10) of the Indian Child Welfare Act of 1978.[66] For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (which after adjusted for inflation is $45,000 for 2013). In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a five percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee's services relate to gaming activities or are performed in a building housing such activities.

The wage credit is available for wages paid or incurred in taxable years that begin on or before December 31, 2013.

REASONS FOR CHANGE

To further encourage employment on Indian reservations, the Committee believes it is appropriate to extend the Indian employment credit an additional two years.

EXPLANATION OF PROVISION

The provision extends for two years the present-law employment credit provision (through taxable years beginning on or before December 31, 2015).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2013.

5. Extension and modification of new markets tax credit (sec. 115 of the bill and sec. 45D of the Code)

PRESENT LAW

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[67] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest

[65] Pub. L. No. 93–262.
[66] Pub. L. No. 95–608.
[67] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106–554.

is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years.[68] The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.[69] The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed.[70]

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE.[71] A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired at its original issue directly (or through an underwriter) from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder.[350] Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments and the investment must be designated as a qualified equity investment by the CDE. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.[72]

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income.[73] For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

[68] Sec. 45D(a)(2).
[69] Sec. 45D(a)(3).
[70] Sec. 45D(g).
[71] Sec. 45D(c).
[72] Sec. 45D(d).
[73] Sec. 45D(e).

The Secretary is authorized to designate "targeted populations" as low-income communities for purposes of the new markets tax credit.[74] For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994[75] (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of—80 percent of the area median family income, or 80 percent of the statewide non-metropolitan area median family income.[76] A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391 of the Code, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of the business is used in a low-income community; (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of the business is attributable to certain financial property or to certain collectibles.[77]

The maximum annual amount of qualified equity investments was $3.5 billion for calendar years 2010, 2011, 2012, and 2013. The new markets tax credit expired on December 31, 2013. No amount of unused allocation limitation may be carried to any calendar year after 2018.

REASONS FOR CHANGE

The Committee believes that the new markets tax credit has proved to be an effective means of providing equity and other investments to benefit businesses in low income communities, and that it is appropriate to provide for the allocation of additional tax credit authority for another two calendar years. The Committee also believes that providing for an allocation for certain areas impacted by declines in manufacturing would spur manufacturing investment to help create jobs and replace jobs that those communities lost.

EXPLANATION OF PROVISION

The provision extends the new markets tax credit for two years, through 2015, permitting up to $3.5 billion in qualified equity in-

[74] Sec. 45D(e)(2).
[75] Pub. L. No. 103–325.
[76] Pub. L. No. 103–325.
[77] Sec. 45D(d)(2).

vestments for each of the 2014 and 2015 calendar years. The provision also extends for two years, through 2020, the carryover period for unused new markets tax credits.

The provision also modifies the new markets tax credit to include allocations for certain areas impacted by declines in manufacturing. The provision allows unallocated amounts of the new markets tax credit to be carried forward after December 31, 2018, but only if such amounts are made available for qualified community development entities a significant mission of which is providing investments and services to persons in the trade or business of manufacturing products in communities which have suffered major manufacturing job losses or a major manufacturing job loss event, as designated by the Secretary.

EFFECTIVE DATE

The provision applies to calendar years beginning after December 31, 2013.

6. Extension of railroad track maintenance credit (sec. 116 of the bill and sec. 45G of the Code)

PRESENT LAW

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during taxable years beginning before January 1, 2014.[78] The credit is limited to the product of $3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year, and (2) assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the taxable year.[79] Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. The credit also may reduce a taxpayer's tax liability below its tentative minimum tax.[80] Basis of the railroad track must be reduced (but not below zero) by an amount equal to 100 percent of the taxpayer's qualified railroad track maintenance tax credit determined for the taxable year.[81]

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of Januaryµ1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).[82]

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only

[78] Secs. 45G(a) and (f).
[79] Sec. 45G(b)(1).
[80] Sec. 38(c)(4).
[81] Sec. 45G(e)(3).
[82] Sec. 45G(d).

with respect to miles of railroad track assigned to such person by such railroad under the provision.[83]

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.[84]

REASONS FOR CHANGE

The Committee believes that Class II and Class III railroads are an important part of the nation's railway system. Therefore, the Committee believes that this incentive for railroad track maintenance expenditures should be extended.

EXPLANATION OF PROVISION

The provision extends the present law credit for two years, for qualified railroad track maintenance expenditures paid or incurred in taxable years beginning before January 1, 2016.

EFFECTIVE DATE

The provision is effective for expenditures paid or incurred in taxable years beginning after December 31, 2013.

7. Extension of mine rescue team training credit (sec. 117 of the bill and sec. 45N of the Code)

PRESENT LAW

An eligible employer may claim a general business credit against income tax with respect to each qualified mine rescue team employee equal to the lesser of: (1) 20 percent of the amount paid or incurred by the taxpayer during the taxable year with respect to the training program costs of the qualified mine rescue team employee (including the wages of the employee while attending the program); or (2) $10,000.[85] A qualified mine rescue team employee is any full-time employee of the taxpayer who is a miner eligible for more than six months of a taxable year to serve as a mine rescue team member by virtue of either having completed the initial 20 hour course of instruction prescribed by the Mine Safety and Health Administration's Office of Educational Policy and Development, or receiving at least 40 hours of refresher training in such instruction.[86]

An eligible employer is any taxpayer which employs individuals as miners in underground mines in the United States.[87] The term "wages" has the meaning given to such term by section 3306(b)[88] (determined without regard to any dollar limitation contained in that section).[89]

No deduction is allowed for the portion of the expenses otherwise deductible that is equal to the amount of the credit.[90] The credit does not apply to taxable years beginning after December 31,

[83] Sec. 45G(c).
[84] Sec. 45G(e)(1).
[85] Sec. 45N(a).
[86] Sec. 45N(b).
[87] Sec. 45N(c).
[88] Section 3306(b) defines wages for purposes of Federal Unemployment Tax.
[89] Sec. 45N(d).
[90] Sec. 280C(e).

2013.[91] Additionally, the credit is not allowable for purposes of computing the alternative minimum tax.[92]

REASONS FOR CHANGE

The Committee believes that training mine rescue team employees will help ensure a positive outcome for individuals operating in and around a mine in the event of an accident. Therefore, the Committee believes that this incentive for costs incurred to train mine rescue teams should be extended.

EXPLANATION OF PROVISION

The provision extends the credit for two years through taxable years beginning on or before December 31, 2015.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2013.

8. Employer wage credit for employees who are active duty members of the uniformed services (sec. 118 of the bill and sec. 45P of the Code)

PRESENT LAW

Differential pay

In general, compensation paid by an employer to an employee is deductible by the employer unless the expense must be capitalized.[93] In the case of an employee who is called to active duty with respect to the armed forces of the United States, some employers voluntarily pay the employee the difference between the compensation that the employer would have paid to the employee during the period of military service less the amount of pay received by the employee from the military. This payment by the employer is often referred to as "differential pay."

Wage credit for differential pay

If an employer qualifies as an eligible small business employer, the employer is allowed a credit against its income tax liability for a taxable year in an amount equal to 20 percent of the sum of the eligible differential wage payments for each of the employer's qualified employees during the year.

An eligible small business employer means, with respect to a taxable year, an employer that: (1) employed on average less than 50 employees on business days during the taxable year; and (2) under a written plan of the taxpayer, provides eligible differential wage payments to every qualified employee. For this purpose, members of controlled groups, groups under common control, and affiliated service groups are treated as a single employer.[94] The credit is not available with respect to an employer that has failed to comply

[91] Sec. 45N(e).
[92] Sec. 38(c).
[93] Sec. 162(a)(1).
[94] Sec. 414(b), (c), (m) and (o).

with the employment and reemployment rights of members of the uniformed services.[95]

Differential wage payment means any payment that: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services of the United States while on active duty for a period of more than 30 days; and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer.[96] Eligible differential wage payments are so much of the differential wage payments paid to a qualified employee as does not exceed $20,000. A qualified employee is an individual who has been an employee of the employer for the 91-day period immediately preceding the period for which any differential wage payment is made.

No deduction may be taken for that portion of compensation that is equal to the credit.[97] In addition, the amount of any other income tax credit otherwise allowable with respect to compensation paid to an employee must be reduced by the differential wage payment credit allowed with respect to the employee. The credit is not allowable against a taxpayer's alternative minimum tax liability. Certain rules applicable to the work opportunity tax credit in the case of tax-exempt organizations, estates and trusts, and regulated investment companies, real estate investment trusts and certain cooperatives apply also to the differential wage payment credit.[98]

The credit is available with respect to amounts paid after June 17, 2008,[99] and before January 1, 2014.

REASONS FOR CHANGE

The credit for differential wage payments serves to encourage employers to make differential wage payments to employees who are serving on active duty in the military. Besides continuing the current incentive by extending the credit, the Committee wishes to expand its incentive effect by making the credit available to all employers, regardless of size, and to increase the credit rate.

EXPLANATION OF PROVISION

The provision extends the availability of the differential wage payment credit for two years to amounts paid before January 1, 2016.

The provision also modifies the credit by making it available to an employer of any size, rather than only to eligible small business employers, and by increasing the credit rate to 100 percent of eligible differential wage payments (that is, differential wage payments up to $20,000).

EFFECTIVE DATE

The provision applies to payments made after December 31, 2013.

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[95] Chapter 43 of Title 38 of the United States Code deals with these rights.
[96] Sec. 3401(h)(2).
[97] Sec. 280C(a).
[98] Sec. 52(c), (d), (e).
[99] The credit was originally provided by the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act"), Pub. L. No. 110–245, effective for amounts paid after June 17, 2008, the date of enactment of the HEART Act.

9. Extension and modification of work opportunity tax credit (sec. 119 of the bill and secs. 51 and 52 of the Code)

PRESENT LAW

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

(1) Families receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (e.g., a State employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified veteran

Prior to enactment of the "VOW to Hire Heroes Act of 2011" (the "VOW Act"),[100] there were two subcategories of qualified veterans to whom wages paid by an employer were eligible for the credit. Employers who hired veterans who were eligible to receive assistance under a supplemental nutritional assistance program were entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages paid to such individual.[101] Employers who hired veterans who were entitled to compensation for a service-connected disability were entitled to a maximum wage credit of 40 percent of $12,000 of qualified first-year wages paid to such individual.[102]

The VOW Act modified the work opportunity credit with respect to qualified veterans, by adding additional subcategories. There are now five subcategories of qualified veterans: (1) in the case of vet-

[100] Pub. L. No. 112–56 (Nov. 21, 2011).

[101] For these purposes, a qualified veteran must be certified by the designated local agency as a member of a family receiving assistance under a supplemental nutrition assistance program under the Food and Nutrition Act of 2008 for a period of at least three months part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a supplemental nutrition assistance program under the Food and Nutrition Act of 2008.

[102] The qualified veteran must be certified as entitled to compensation for a service-connected disability and (1) have a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States; or (2) have been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring. For these purposes, being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S. Code, which means having a disability rating of 10 percent or higher for service connected injuries.

erans who were eligible to receive assistance under a supplemental nutritional assistance program (for at least a three month period during the year prior to the hiring date) the employer is entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of $12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service connected disability, and who has been unemployed for an aggregate of at least six months during the one year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of $24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $14,000 of qualified first-year wages.

A veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not a qualified veteran if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(3) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law; and (2) having a hiring date within one year of release from prison or the date of conviction.

(4) Designated community resident

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community or a rural renewal community. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990–1994 and 1995–1999. Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community or a rural renewal community.

(5) Vocational rehabilitation referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a State plan approved under the Rehabilitation Act of 1973; (b) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code; or (c) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified summer youth employee

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15; (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date; (3) who has not been an employee of that employer before; and (4) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community. As with designated community residents, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified supplemental nutrition assistance program benefits recipient

A qualified supplemental nutrition assistance program benefits recipient is an individual at least age 18 but not yet age 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food and nutrition program under the Food and Nutrition Act of 2008 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food and nutrition assistance under section 6(o) of the Food and Nutrition Act of 2008, the six-month requirement is replaced with a requirement that the family has been receiving food and nutrition assistance for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food and nutrition assistance program under the Food and Nutrition Act of 2008.

(8) Qualified SSI recipient

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income ("SSI") benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-term family assistance recipient

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit) if the individual is hired within two years after the date that the 18-month total is reached; or (3) a member of a family who is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within two years after the Federal or State time limits made the family ineligible for family assistance.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). 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). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

For calculation of the credit with respect to qualified veterans, see the description of "qualified veteran" above.

Certification rules

Generally, an individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

An otherwise qualified unemployed veteran is treated as certified by the designated local agency as having aggregate periods of unemployment (whichever is applicable under the qualified veterans rules described above) if such veteran is certified by such agency as being in receipt of unemployment compensation under a State or Federal law for such applicable periods. The Secretary of the Treasury is authorized to provide alternative methods of certification for unemployed veterans.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Qualified tax-exempt organizations employing qualified veterans

The credit is not available to qualified tax-exempt organizations other than those employing qualified veterans. The special rules, described below, were enacted in the VOW Act.

If a qualified tax-exempt organization employs a qualified veteran (as described above) a tax credit against the FICA taxes of the organization is allowed on the wages of the qualified veteran which are paid for the veteran's services in furtherance of the activities related to the function or purpose constituting the basis of the organization's exemption under section 501.

The credit available to such tax-exempt employer for qualified wages paid to a qualified veteran equals 26 percent (16.25 percent for employment of 400 hours or less) of qualified first-year wages. The amount of qualified first-year wages eligible for the credit is the same as those for non-tax-exempt employers (i.e., $6,000, $12,000, $14,000 or $24,000, depending on the category of qualified veteran).

A qualified tax-exempt organization means an employer that is described in section 501(c) and exempt from tax under section 501(a).

The Social Security Trust Funds are held harmless from the effects of this provision by a transfer from the Treasury General Fund.

Treatment of possessions

The VOW Act provided a reimbursement mechanism for the U.S. possessions (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the United States Virgin Islands). The Treasury Secretary is to pay to each mirror code possession (Guam, the Commonwealth of the Northern Mariana Islands, and the United States Virgin Islands) an amount equal to the loss to that possession as a result of the VOW Act changes to the qualified veterans rules. Similarly, the Treasury Secretary is to pay to each non-mirror Code possession (American Samoa and the Commonwealth of Puerto Rico) the amount that the Secretary estimates as being equal to the loss to that possession that would have occurred as a result of the VOW Act changes if a mirror code tax system had been in effect in that possession. The Secretary will make this payment to a non-mirror Code possession only if that possession establishes to the satisfaction of the Secretary that the possession has implemented (or, at the discretion of the Secretary, will implement) an income tax benefit that is substantially equivalent to the qualified veterans credit allowed under the VOW Act modifications.

An employer that is allowed a credit against U.S. tax under the VOW Act with respect to a qualified veteran must reduce the amount of the credit claimed by the amount of any credit (or, in the case of a non-mirror Code possession, another tax benefit) that the employer claims against its possession income tax.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2013.

REASONS FOR CHANGE

Given the level of unemployment and general economic conditions, the Committee believes that the credit should be extended and expanded. By expanding the credit to long-term unemployed individuals, the Committee believes it is providing an incentive for employers to hire individuals who have suffered particularly acute harm during the economic downturn.

EXPLANATION OF PROVISION

The provision extends for two years the present-law employment credit provision (through taxable years beginning on or before December 31, 2015). Additionally, the provision expands the work opportunity tax credit to employers who hire individuals who are qualified long-term unemployment recipients. For purposes of the provision, such persons are individuals who have been certified by the designated local agency as being in a period of unemployment of 27 weeks or more, which includes a period in which the individual was receiving unemployment compensation under State or Federal law. With respect to wages paid to such individuals, employers would be eligible for a 40 percent credit on the first $6,000 of wages paid to such individual, for a maximum credit of $2,400 per eligible employee.

EFFECTIVE DATE

The provision is effective for individuals who begin work for the employer after December 31, 2013.

10. Extension of qualified zone academy bonds (sec. 120 of the bill and secs. 54E and 6431 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. These can include tax-exempt bonds which finance public schools.[103] An issuer must file with the Internal Revenue Service certain information about the bonds issued in order for that bond issue to be tax-exempt.[104] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[105] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[106] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue "qualified zone academy bonds."[107] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years

[103] Sec. 103.
[104] Sec. 149(e).
[105] Sec. 103(a) and (b)(2).
[106] Sec. 148.
[107] See secs. 54E and 1397E.

1998 through 2008, $1,400 million in 2009 and 2010, and $400 million in 2011, 2012 and 2013. Each calendar years bond limitation is allocated 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.

A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

Qualified zone academy bonds are a type of qualified tax credit bond and subject to the general rules applicable to qualified tax credit bonds.[108] 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.[109] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on 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 100 percent of the available project proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Under section 6431 of the Code, an issuer of specified tax credit bonds, may elect to receive a payment in lieu of a credit being allowed to the holder of the bond ("direct-pay bonds"). The Code provides that section 6431 is not available for qualified zone academy bond allocations from the 2011 national limitation or any carry forward of the 2011 allocation.[110]

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[108] Sec. 54A.

[109] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

[110] Sec. 6431(f)(3)(A)(iii). A technical correction may be needed to conform the Code to provide that section 6431 is not available for any allocations from national limitation or carryforward for years 2011 and thereafter.

REASONS FOR CHANGE

The Committee believes there is a continuing need to finance school renovations and therefore, extension of the qualified zone academy bond program is warranted. Further, the Committee believes that the inability to attract sufficient private contributions to meet the current 10 percent private contribution requirement may hinder the ability of some school districts to fully utilize the qualified zone academy bond program. Therefore, the Committee believes it is appropriate to lower the required match to five percent to make the requirement more manageable for school districts to meet.

EXPLANATION OF PROVISION

The provision extends the qualified zone academy bond program for two additional years. The provision authorizes issuance of up to $400 million of qualified zone academy bonds per year for 2014 and 2015. The option to issue direct-pay bonds is not available for the 2014 and 2015 bond limitation.

The provision makes two additional changes with respect to qualified zone academy bonds. First, the provision makes a technical correction to conform the Code to Congressional intent that qualified zone academy bonds cannot be issued as direct-pay bonds using national limitation allocations or carryforwards from years after 2010. Second, the provision reduces the private business contribution requirement from 10 percent to five percent.

EFFECTIVE DATE

The provision generally applies to obligations issued after December 31, 2013. The technical correction is effective as if included in section 310 of American Taxpayer Relief Act of 2012.

11. Extension of classification of certain race horses as three-year property (sec. 121 of the bill and sec. 168 of the Code)

PRESENT LAW

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization.[111] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods,[112] placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[113] In particular, the statute assigns a three-year recovery period for any race horse (1) that is placed in service after December

[111] See secs. 263(a) and 167.

[112] The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Revenue Procedure 87–56 (1987–2 C.B. 674), laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Revenue Procedure 88–22 (1988–1 C.B. 785). In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Revenue Procedure 87–56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[113] Sec. 168.

31, 2008 and before January 1, 2014[114] and (2) that is placed in service after December 31, 2013 and that is more than two years old at such time it is placed in service by the purchaser.[115]

REASONS FOR CHANGE

The Committee believes that the horse industry is important to a number of State and local economies. Therefore, the Committee believes that this incentive for race horses should be extended.

EXPLANATION OF PROVISION

The provision extends the present-law three-year recovery period for race horses for two years to apply to any race horse (regardless of age when placed in service) before January 1, 2016.

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2013.

12. Extension of 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (sec. 122 of the bill and sec. 168 of the Code)

PRESENT LAW

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[116] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year in which property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresi-

[114] Sec. 168(e)(3)(A)(i)(I), as in effect after amendment by the Food, Conservation and Energy Act of 2008, Pub. L. No. 110–246, sec. 15344(b).

[115] Sec. 168(e)(3)(A)(i)(II). A horse is more than 2 years old after the day that is 24 months after its actual birthdate. Rev. Proc. 87–56, 1987–2 C.B. 674, as clarified and modified by Rev. Proc. 88–22, 1988–1 C.B. 785.

[116] Sec. 168.

dential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2014. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[117] The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.[118] If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement.[119] An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.[120]

Qualified leasehold improvement property is generally recovered using the straight-line method and a half-year convention.[121] Qualified leasehold improvement property placed in service after December 31, 2013 is subject to the general rules described above.

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2014. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building, if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.[122] Qualified restaurant property is recovered using the straight-line method and a half-year convention.[123] Additionally, qualified restaurant property is not eligible for bonus depreciation.[124] Qualified restaurant property placed in service after December 31, 2013 is subject to the general rules described above.

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[117] Sec. 168(e)(6).
[118] Secs. 168(e)(6) and (k)(3).
[119] Sec. 168(e)(6)(A).
[120] Sec. 168(e)(6)(B).
[121] Secs.168(b)(3)(G) and 168(d).
[122] Sec. 168(e)(7).
[123] Secs. 168(b)(3)(H) and 168(d).
[124] Sec. 168(e)(7)(B). Property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property is eligible for bonus depreciation. Sec. 3.03(3) of Rev. Proc. 2011–26, 2011–16 I.R.B. 664, 2011.

Qualified retail improvement property

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property placed in service before January 1, 2014. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public[125] and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.[126] Qualified retail 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.[127] In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.[128]

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores, and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. Generally, it is intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.

Qualified retail improvement property is recovered using the straight-line method and a half-year convention.[129] Additionally, qualified retail improvement property is not eligible for bonus depreciation.[130] Qualified retail improvement property placed in service after December 31, 2013 is subject to the general rules described above.

REASONS FOR CHANGE

The Committee believes that taxpayers should not be required to recover the costs of certain leasehold improvements beyond the useful life of the investment. The 39-year recovery period for leasehold improvements for property placed in service after December 31, 2013, extends beyond the useful life of many such investments. Although lease terms differ, the Committee believes that lease terms for commercial real estate are also typically shorter than the 39-year recovery period. In the interests of simplicity and administrability, a uniform period for the recovery of leasehold improvements is desirable. Therefore, the provision extends the 15-year recovery period for leasehold improvements.

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125 Improvements to portions of a building not open to the general public (*e.g.,* stock room in back of retail space) do not qualify under the provision.

126 Sec. 168(e)(8).

127 Sec. 168(e)(8)(C).

128 Sec. 168(e)(8)(B).

129 Secs. 168(b)(3)(I) and 168(d).

130 Sec. 168(e)(8)(D). Property that satisfies the definition of both qualified leasehold improvement property and qualified retail improvement property is eligible for bonus depreciation. Sec. 3.03(3) of Rev. Proc. 2011–26, 2011–16 I.R.B. 664, 2011.

The Committee also believes that unlike other commercial buildings, restaurant buildings generally are more specialized structures. Restaurants also experience considerably more traffic and remain open longer than most commercial properties. This daily use causes rapid deterioration of restaurant properties and forces restaurateurs to constantly repair and upgrade their facilities. As such, restaurant facilities generally have a shorter life span than other commercial establishments. The provision extends the 15-year recovery period for improvements made to restaurant buildings and continues to apply the 15-year recovery period to new restaurants, to more accurately reflect the true economic life of such properties.

The Committee believes that taxpayers should not be required to recover the costs of certain improvements beyond the useful life of the investment. The 39-year recovery period for improvements to owner-occupied (i.e., not leased) retail property extends beyond the useful life of many such investments. Additionally, the Committee believes that retailers should not be treated differently based on whether the building in which they operate is owned or leased. As many small business retailers own the building in which they operate their business, the Committee believes this provision will provide relief to small businesses. Therefore, the provision extends the 15-year recovery period for qualified retail improvements.

EXPLANATION OF PROVISION

The provision extends the present-law provisions for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property for two years to apply to property placed in service before January 1, 2016.

EFFECTIVE DATE

The provision is effective for property placed in service after December 31, 2013.

13. Extension of seven-year recovery period for motorsports entertainment complexes (sec. 123 of the bill and sec. 168 of the Code)

PRESENT LAW

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization.[131] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods,[132] placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[133] The cost of nonresidential real property is recovered using

[131] See secs. 263(a) and 167.

[132] The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Revenue Procedure 87–56 (1987–2 C.B. 674), laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Revenue Procedure 88–22 (1988–1 C.B. 785). In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Revenue Procedure 87–56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[133] Sec. 168.

the straight-line method of depreciation and a recovery period of 39 years.[134] Nonresidential real property is subject to the mid-month convention, which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month.[135] All other property generally is subject to the half-year convention, which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year.[136] Land improvements (such as roads and fences) are recovered using the 150-percent declining balance method and a recovery period of 15 years.[137] An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years.[138] Additionally, a motorsports entertainment complex placed in service on or before December 31, 2013 is assigned a recovery period of seven years.[139] For these purposes, a motorsports entertainment complex means a racing track facility which is permanently situated on land and which during the 36-month period following its placed-in-service date hosts a racing event.[140] The term motorsports entertainment complex also includes ancillary facilities, land improvements (e.g., parking lots, sidewalks, fences), support facilities (e.g., food and beverage retailing, souvenir vending), and appurtenances associated with such facilities (e.g., ticket booths, grandstands).

REASONS FOR CHANGE

The Committee believes that extending the depreciation incentive will encourage State and local economic development. Thus, the provision extends the seven-year recovery period for motorsports entertainment complex property.

EXPLANATION OF PROVISION

The provision extends the present-law seven-year recovery period for motorsports entertainment complexes for two years to apply to property placed in service on or before December 31, 2015.

EFFECTIVE DATE

The provision is effective for property placed in service after December 31, 2013.

[134] Secs. 168(b)(3)(A) and 168(c).

[135] Secs. 168(d)(2)(A) and (d)(4)(B).

[136] Secs. 168(d)(1) and (d)(4)(A). However, if substantial property is placed in service during the last three months of a taxable year, a special rule requires use of the mid-quarter convention, which treats all property placed in service (or disposed of) during any quarter as placed in service (or disposed of) on the mid-point of such quarter. Secs. 168(d)(3) and (d)(4)(C).

[137] Sec. 168(b)(2)(A) and asset class 00.3 of Rev. Proc. 87–56, 1987–2 C.B. 674, 1987. Under the 150-percent declining balance method, the depreciation rate is determined by dividing 150 percent by the appropriate recovery period, switching to the straight-line method for the first taxable year where using the straight-line method with respect to the adjusted basis as of the beginning of that year will yield a larger depreciation allowance. Secs. 168(b)(2) and (b)(1)(B).

[138] Asset class 80.0 of Rev. Proc. 87–56, 1987–2 C.B. 674, 1987.

[139] Sec. 168(e)(3)(C)(ii).

[140] Sec. 168(i)(15).

14. Extension of accelerated depreciation for business property on an Indian reservation (sec. 124 of the bill and sec. 168(j) of the Code)

PRESENT LAW

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j) are determined using the following recovery periods:

3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Nonresidential real property	22 years[141]

"Qualified Indian reservation property" eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer; [142] and (4) is not property placed in service for purposes of conducting gaming activities.[143] Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).[144]

An "Indian reservation" means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d)) [145] or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).[146] For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).[147]

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax.[148] The accelerated depreciation for qualified Indian reservation property is available with respect to property placed in service on or before December 31, 2013.[149]

[141] Section 168(j)(2) does not provide shorter recovery periods for water utility property, residential rental property, or railroad grading and tunnel bores.

[142] For these purposes, related persons is defined in section 465(b)(3)(C).

[143] Sec. 168(j)(4)(A).

[144] Sec. 168(j)(4)(C).

[145] Pub. L. No. 93–262.

[146] Pub. L. No. 95–608.

[147] Sec. 168(j)(6).

[148] Sec. 168(j)(3).

[149] Sec. 168(j)(8).

REASONS FOR CHANGE

The Committee believes that extending this depreciation incentive will encourage economic development within Indian reservations and expand employment opportunities on such reservations.

EXPLANATION OF PROVISION

The provision extends for two years the present-law accelerated depreciation for qualified Indian reservation property to apply to property placed in service on or before December 31, 2015.

EFFECTIVE DATE

The provision is effective for property placed in service after December 31, 2013.

15. Extension of bonus depreciation (sec. 125 of the bill and sec. 168(k) of the Code)

PRESENT LAW

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property placed in service acquired after December 31, 2007 and placed in service either before September 9, 2010 or after December 31, 2011 and before January 1, 2014 (January 1, 2015 for certain longer-lived and transportation property).[150] An additional first-year depreciation deduction is allowed equal to 100 percent of the adjusted basis of qualified property if it meets the requirements for the additional first-year depreciation and also meets the following requirements.[151] First, the taxpayer must acquire the property after September 8, 2010 and before January 1, 2012 (January 1, 2013 for certain longer-lived and transportation property).[152] Second, the taxpayer must place the property in service after September 8, 2010 and before January 1, 2012 (January 1, 2013 in the case of certain longer-lived and transportation property). Third, the original use of the property must commence with the taxpayer after September 8, 2010.[153]

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes,[154] but is not allowed for purposes of computing earnings and profits.[155] 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.[156] In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies.[157] The amount of the additional first-year depreciation de-

[150] Sec. 168(k). The additional first-year depreciation deduction is subject to the general rules regarding whether an item must be capitalized under section 263A.
[151] Sec. 168(k)(5).
[152] For a definition of "acquire" for this purpose, see section 3.02(1)(a) of Rev. Proc. 2011–26, 2011–16 I.R.B. 664, 2011.
[153] See sec. 3.02(1) of Rev. Proc. 2011–26, 2011–16 I.R.B. 664, 2011.
[154] Sec. 168(k)(2)(G).
[155] Treas. Reg. sec. 1.168(k)–1(f)(7).
[156] Sec. 168(k)(1)(B).
[157] Treas. Reg. sec. 1.168(k)–1(d).

duction is not affected by a short taxable year.[158] The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.[159]

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2013, a taxpayer purchased new depreciable property and placed it in service.[160] The property's cost is $1,000, and it is five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed is $500. The remaining $500 of the cost of the property is depreciable under the rules applicable to five-year property. Thus, 20 percent, or $100, also is allowed as a depreciation deduction in 2013.[161] The total depreciation deduction with respect to the property for 2013 is $600. The remaining $400 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements. First, the property must be (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) computer software other than computer software covered by section 197; or (4) qualified leasehold improvement property (as defined in section 168(k)(3)).[162] Second, the original use[163] of the property must commence with the taxpayer after December 31, 2007.[164] Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2014. An extension of the placed-in-service date of one year (*i.e.*, before January 1, 2015) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.[165]

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[158] *Ibid.*

[159] Sec. 168(k)(2)(D)(iii).

[160] Assume that the cost of the property is not eligible for expensing under section 179.

[161] This simplified example ignores the applicable convention (e.g., half-year).

[162] The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. Sec. 168(k)(2)(D)(i). The additional first-year depreciation deduction also is not available for qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c)(2). Sec. 168(k)(2)(D)(ii).

[163] 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. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (*i.e.*, each fractional owner is considered the original user of its proportionate share of the property). Treas. Reg. sec. 1.168(k)–1(b)(3).

[164] 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. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. Sec. 168(k)(2)(E)(ii).

[165] Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service-date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000.

To qualify, property must be acquired (1) after December 31, 2007, and before January 1, 2014, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was entered into after December 31, 2007, and before January 1, 2014.[166] With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2014.[167] 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.[168] For property eligible for the extended placed-in-service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2014 ("progress expenditures") is eligible for the additional first-year depreciation deduction.[169]

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner.[170] For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year deduction).[171] The $8,000 increase is not indexed for inflation.

Special rule for long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method. Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less is taken into

[166] Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to January 1, 2008.

[167] Sec. 168(k)(2)(E)(i).

[168] Treas. Reg. sec. 1.168(k)–1(b)(4)(iii).

[169] Sec. 168(k)(2)(B)(ii). For purposes of determining the amount of eligible progress expenditures, rules similar to section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

[170] Sec. 168(k)(2)(E)(iv).

[171] Sec. 168(k)(2)(F).

account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service (1) after December 31, 2009 and before January 1, 2011 (January 1, 2012 in the case of certain longer-lived and transportation property) or (2) after December 31, 2012 and before January 1, 2014 (January 1, 2015 in the case of certain longer-lived and transportation property).[172] Bonus depreciation generally is taken into account in determining taxable income under the percentage-of-completion method for property placed in service after December 31, 2010 and before January 1, 2013.

Election to accelerate minimum tax credit in lieu of claiming bonus depreciation

A corporation otherwise eligible for additional first year depreciation under section 168(k) may elect to claim additional minimum tax credits in lieu of claiming depreciation under section 168(k) for "eligible qualified property" placed in service after December 31, 2010 and before January 1, 2014 (January 1, 2015 in the case of certain longer-lived and transportation property).[173] A corporation making the election increases the limitation under section 53(c) on the use of minimum tax credits in lieu of taking bonus depreciation deductions.[174] The increases in the allowable credits under this provision are treated as refundable.[175] The depreciation for eligible qualified property is calculated for both regular tax and alternative minimum tax purposes using the straight-line method in place of the method that would otherwise be used absent the election under this provision.[176]

The minimum tax credit limitation is increased by the bonus depreciation amount, which is equal to 20 percent of bonus depreciation[177] for certain eligible qualified property that could be claimed as a deduction absent an election under this provision.

The bonus depreciation amount is limited to the lesser of (1) $30 million or (2) six-percent of the minimum tax credits allocable to the adjusted minimum tax imposed for, taxable years beginning before January 1, 2006.[178] All corporations treated as a single employer under section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.[179]

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, section 168(k)(1) does not apply to any eligible qualified property and the straight-line method is used with respect to such property.[180]

[172] Sec. 460(c)(6).
[173] Sec. 168(k)(4). Eligible qualified property means qualified property eligible for bonus depreciation with minor effective date differences.
[174] Sec. 168(k)(4)(B)(ii).
[175] Sec. 168(k)(4)(F).
[176] Sec. 168(k)(4)(A).
[177] For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation for all eligible qualified property determined if section 168(k)(1) applied using the most accelerated depreciation method (determined without regard to this provision), and the shortest life allowable for each property, and (ii) the amount of depreciation that would be determined if section 168(k)(1) did not apply using the same method and life for each property. Sec. 168(k)(4)(C).
[178] Sec. 168(k)(4)(C)(iii).
[179] Sec. 168(k)(4)(C)(iv).
[180] Sec. 168(k)(4)(G)(ii).

Generally an election under this provision for a taxable year applies to subsequent taxable years.[181]

REASONS FOR CHANGE

The Committee believes that allowing additional first-year depreciation will accelerate purchases of equipment and other assets, and promote capital investment, modernization, and growth.

EXPLANATION OF PROVISION

The provision extends the 50-percent additional first-year depreciation deduction for two years, generally through 2015 (through 2016 for certain longer-lived and transportation property).

The provision provides that solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less which is placed in service after December 31, 2012 and before January 1, 2016 (January 1, 2017, in the case of certain longer-lived and transportation property) is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted.

The provision also extends the election to increase the AMT credit limitation in lieu of bonus depreciation for two years to property placed in service before January 1, 2016 (January 1, 2017, in the case of certain longer-lived property and transportation property). A bonus depreciation amount, maximum amount, and maximum increase amount is computed separately with respect to property to which the extension of additional first-year depreciation applies ("round 4 extension property").[182]

Under the provision, a corporation that has an election in effect with respect to round 3 extension property to claim minimum tax credits in lieu of bonus depreciation is treated as having an election in effect for round 4 extension property, unless the corporation elects otherwise. The provision also allows a corporation that does not have an election in effect with respect to round 3 extension property to elect to claim minimum tax credits in lieu of bonus depreciation for round 4 extension property. A separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to round 4 extension property.[183]

The provision also includes a technical correction with respect to the taxable year for which an election under section 168(k)(4) is made.

EFFECTIVE DATE

Except as noted below, the provision is effective for property placed in service after December 31, 2013, in taxable years ending after such date.

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[181] Special election rules apply as the result of prior extensions of this provision. See secs. 168(k)(4)(H), (I) and (J).

[182] An election with respect to round 4 extension property is binding for all property that is eligible qualified property solely by reason of the extension of the 50-percent additional first-year depreciation deduction.

[183] In computing the maximum amount, the maximum increase amount for round 4 extension property is reduced by bonus depreciation amounts for preceding taxable years only with respect to round 4 extension property.

The technical correction to section 168(k)(4) is effective as if originally included in section 331 of the American Taxpayer Relief Act of 2012.[184]

16. Extension of enhanced charitable deduction for contributions of food inventory (sec. 126 of the bill and sec. 170 of the Code)

PRESENT LAW

Charitable contributions in general

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization.[185]

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

General rules regarding contributions of inventory

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less the fair market value of the inventory.

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[186] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[187] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer and must be contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.[188] In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, as amended, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.[189]

[184] Pub. L. No. 112–240.
[185] Sec. 170.
[186] Sec. 170(e)(3).
[187] Sec. 170(b)(2).
[188] Sec. 170(e)(3)(A)(i)–(iii).
[189] Sec. 170(e)(3)(A)(iv).

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[190]

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.[191]

Temporary rule expanding and modifying the enhanced deduction for contributions of food inventory

Under a temporary provision, any taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim the enhanced deduction for donations of food inventory.[192] For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporations) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.[193]

Under the temporary provision, the enhanced deduction for food is available only for food that qualifies as "apparently wholesome food." Apparently wholesome food is defined as food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

The provision does not apply to contributions made after December 31, 2013.

REASONS FOR CHANGE

The Committee believes that charitable organizations benefit from charitable contributions of food inventory by non C corpora-

[190] Treas. Reg. sec. 1.170A–4A(c)(3).

[191] Lucky Stores Inc. v. Commissioner, 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).

[192] Sec. 170(e)(3)(C).

[193] The 10 percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory by a taxpayer that is not a C corporation that exceed the 10 percent limitation but not the 50 percent limitation could not be carried forward.

tions and that the enhanced deduction is a useful incentive for the making of such contributions. Accordingly, the Committee believes it is appropriate to extend the special rule for charitable contributions of food inventory for two years.

EXPLANATION OF PROVISION

The provision extends the expansion of, and modifications to, the enhanced deduction for charitable contributions of food inventory to contributions made before January 1, 2016.

EFFECTIVE DATE

The provision is effective for contributions made after December 31, 2013.

17. Extension and modification of increased expensing limitations and treatment of certain real property as section 179 property (sec. 127 of the bill and sec. 179 of the Code)

PRESENT LAW

A taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation.[194] For taxable years beginning in 2013, the maximum amount a taxpayer may expense is $500,000 of the cost of qualifying property placed in service for the taxable year.[195] The $500,000 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 $2,000,000.[196] The $500,000 and $2,000,000 amounts are not indexed for inflation. 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.[197] For taxable years beginning before 2014, qualifying property also includes off-the-shelf computer software and qualified real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).[198] Of the $500,000 expense amount available under section 179, the maximum amount available with respect to qualified real property is $250,000 for each taxable year.[199]

[194] Additional section 179 incentives have been provided with respect to qualified property meeting applicable requirements that is used by a business in an enterprise zone (sec. 1397A), a renewal community (sec. 1400J), the New York Liberty Zone (sec. 1400L(f)), or the Gulf Opportunity Zone (sec. 1400N(e)). In addition, section 179(e) provides for an enhanced section 179 deduction for qualified disaster assistance property.

[195] For the years 2003 through 2006, the relevant dollar amount is $100,000 (indexed for inflation); in 2007, the dollar limitation is $125,000; for the 2008 and 2009 years, the relevant dollar amount is $250,000; and for 2010, 2011, and 2012, the relevant dollar limitation is $500,000. Sec. 179(b)(1).

[196] For the years 2003 through 2006, the relevant dollar amount is $400,000 (indexed for inflation); in 2007, the dollar limitation is $500,000; for the 2008 and 2009 years, the relevant dollar amount is $800,000; and for 2010, 2011, and 2012, the relevant dollar limitation is $2,000,000. Sec. 179(b)(2).

[197] Qualifying property does not include any property described in section 50(b), air conditioning units, or heating units. Sec. 179(d)(1). Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F. For sport utility vehicles above the 6,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for any taxable year under section 179 is $25,000. Sec. 179(b)(5).

[198] Secs. 179(d)(1)(A)(ii) and (f).

[199] Sec. 179(f)(3).

For taxable years beginning in 2014 and thereafter, a taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year, subject to limitation. The $25,000 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. The $25,000 and $200,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property (not including off-the-shelf computer software or qualified real property) that is purchased for use in the active conduct of a trade or business.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision).[200] 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 limitations). However, amounts attributable to qualified real property that are disallowed under the trade or business income limitation may only be carried over to taxable years in which the definition of eligible section 179 property includes qualified real property.[201] Thus, if a taxpayer's section 179 deduction for 2012 with respect to qualified real property is limited by the taxpayer's active trade or business income, such disallowed amount may be carried over to 2013. Any such carryover amounts that are not used in 2013 are treated as property placed in service in 2013 for purposes of computing depreciation. That is, the unused carryover amount from 2012 is considered placed in service on the first day of the 2013 taxable year.[202]

No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.[203] If a corporation makes an election under section 179 to deduct expenditures, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted reduce corporate earnings and profits ratably over a five-year period.[204]

An expensing election is made under rules prescribed by the Secretary.[205] In general, any election or specification made with respect to any property may not be revoked except with the consent of the Commissioner. However, an election or specification under section 179 may be revoked by the taxpayer without consent of the Commissioner for taxable years beginning after 2002 and before 2014.[206]

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[200] Sec. 179(b)(3).

[201] Section 179(f)(4) details the special rules that apply to disallowed amounts.

[202] For example, assume that during 2012, a company's only asset purchases are section 179–eligible equipment costing $100,000 and qualifying leasehold improvements costing $200,000. Assume the company has no other asset purchases during 2012, and has a taxable income limitation of $150,000. The maximum section 179 deduction the company can claim for 2012 is $150,000, which is allocated pro rata between the properties, such that the carryover to 2013 is allocated $100,000 to the qualified leasehold improvements and $50,000 to the equipment.

Assume further that in 2013, the company had no asset purchases and had no taxable income. The $100,000 carryover from 2012 attributable to qualified leasehold improvements is treated as placed in service as of the first day of the company's 2013 taxable year. The $50,000 carryover allocated to equipment is carried over to 2013 under section 179(b)(3)(B).

[203] Sec. 179(d)(9).

[204] Sec. 312(k)(3)(B).

[205] Sec. 179(c)(1).

[206] Sec. 179(c)(2).

REASONS FOR CHANGE

The Committee believes that section 179 expensing provides two important benefits for small businesses. First, it lowers the cost of capital for tangible property used in a trade or business. With a lower cost of capital, the Committee believes small businesses will invest in more equipment and employ more workers. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. In order to increase the value of these benefits and to increase the number of taxpayers eligible, the provision increases the amount allowed to be expensed under section 179 and increases the amount of the phase-out threshold. In addition, in order to counteract the negative impact of inflation on the limit and phase-out threshold of this provision for small businesses, the provision indexes such amounts for inflation.

The Committee also believes that qualified real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) should continue to be included in the section 179 expensing provision to encourage small businesses to invest in these types of real property. Further, the Committee believes that purchased computer software should continue to be included in the section 179 expensing provision so that it is not disadvantaged relative to developed software. In addition, the Committee believes that the process of making and revoking section 179 elections should continue to be simpler and more efficient for taxpayers by eliminating the requirement of the consent of the Commissioner.

EXPLANATION OF PROVISION

The provision provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2014 and 2015, is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 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 $2,000,000. The $500,000 and $2,000,000 amounts are indexed for inflation for taxable years beginning after 2013.

In addition, the provision extends, for taxable years beginning in 2014 and 2015, the treatment of off-the-shelf computer software as qualifying property. The provision also extends the treatment of qualified real property as eligible section 179 property for taxable years beginning in 2014 and 2015, including the limitation on carryovers and the maximum amount available with respect to qualified real property of $250,000 for each taxable year. For taxable years beginning in 2014 and 2015, the provision continues to permit a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2013.

18. Extension of election to expense mine safety equipment (sec. 128 of the bill and sec. 179E of the Code)

PRESENT LAW

A taxpayer may elect to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the taxable year in which the equipment is placed in service.[207] "Qualified advanced mine safety equipment property" means any advanced mine safety equipment property for use in any underground mine located in the United States the original use of which commences with the taxpayer and which is placed in service after December 20, 2006, and before January 1, 2014.[208]

Advanced mine safety equipment property means any of the following: (1) emergency communication technology or devices used to allow a miner to maintain constant communication with an individual who is not in the mine; (2) electronic identification and location devices that allow individuals not in the mine to track at all times the movements and location of miners working in or at the mine; (3) emergency oxygen-generating, self-rescue devices that provide oxygen for at least 90 minutes; (4) pre-positioned supplies of oxygen providing each miner on a shift the ability to survive for at least 48 hours; and (5) comprehensive atmospheric monitoring systems that monitor the levels of carbon monoxide, methane, and oxygen that are present in all areas of the mine and that can detect smoke in the case of a fire in a mine.[209]

REASONS FOR CHANGE

The Committee believes that mine safety equipment is vital to ensuring a safe workplace for the nation's underground mine workforce. Therefore, the Committee believes that this incentive for mine safety equipment property should be extended.

EXPLANATION OF PROVISION

The provision extends for two years (through December 31, 2015) the present-law placed in service date allowing a taxpayer to expense 50 percent of the cost of any qualified advanced mine safety equipment property.

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2013.

19. Extension of special expensing rules for certain film and television productions; Special expensing for live theatrical productions (sec. 129 of the bill and sec. 181 of the Code)

PRESENT LAW

Under section 181, a taxpayer may elect[210] to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2014, in the year the expenditure is incurred in lieu of

[207] Sec. 179E(a).
[208] Secs. 179E(c) and (g).
[209] Sec. 179E(d).
[210] See Treas. Reg. section 1.181–2 for rules on making an election under this section.

capitalizing the cost and recovering it through depreciation allowances.[211] A taxpayer may elect to deduct up to $15 million of the aggregate cost of the film or television production under this section.[212] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[213]

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[214] The term "compensation" does not include participations and residuals (as defined in section 167(g)(7)(B)).[215] Each episode of a television series is treated as a separate production, and only the first 44 episodes of a particular series qualify under the provision.[216] Qualified productions do not include sexually explicit productions as referenced by section 2257 of title 18 of the U.S. Code.[217] It also generally does not include live theatrical productions.

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.[218]

REASONS FOR CHANGE

The Committee believes that section 181 encourages domestic film and television productions and that the provision should be extended. The issue of runaway production (*i.e.*, the production of American film and television projects abroad) affects all productions, regardless of cost, and therefore the Committee believes that it is appropriate to continue to treat as an expense the first $15 million ($20 million in certain cases) of production costs of otherwise qualified film and television productions.

The Committee also believes that section 181 should be expanded to include some types of live theatrical productions in order to encourage investment in and financing of these types of commercial stage productions, thereby resulting in more live theatre jobs and shows. Therefore, the provision allows certain live theatrical productions to qualify for section 181.

EXPLANATION OF PROVISION

The provision extends the special treatment for film and television productions under section 181 for two years to qualified film and television productions commencing prior to January 1, 2016.

The provision also expands section 181 to include any qualified live theatrical production. A qualified live theatrical production is

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[211] For this purpose, a production is treated as commencing on the first date of principal photography.
[212] Sec. 181(a)(2)(A).
[213] Sec. 181(a)(2)(B).
[214] Sec. 181(d)(3)(A).
[215] Sec. 181(d)(3)(B).
[216] Sec. 181(d)(2)(B).
[217] Sec. 181(d)(2)(C).
[218] Sec. 1245(a)(2)(C).

defined as a live staged production of a play (with or without music) which is derived from a written book or script and is produced or presented by a commercial entity in any venue which has an audience capacity of not more than 3,000 or a series of venues the majority of which have an audience capacity of not more than 3,000. Similar to the exclusion for sexually explicit productions from the present-law definition of qualified productions, qualified live theatrical productions do not include stage performances that would be excluded by section 2257(h)(1) of title 18 of the U.S. Code, if such provision were extended to live stage performances. In general, in the case of multiple live staged productions, each such live-staged production is treated as a separate production.

EFFECTIVE DATE

The provision applies to productions commencing after December 31, 2013. For purposes of this provision, the date on which a qualified live theatrical production commences is the date of the first public performance of such production for a paying audience.

20. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sec. 130 of the bill and sec. 199 of the Code)

PRESENT LAW

General

Present law generally provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income for the taxable year. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[219] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[220] produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in

[219] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[220] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

The amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[221] Wages paid to bona fide residents of Puerto Rico generally are not included in the definition of wages for purposes of computing the wage limitation amount.[222]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia.[223] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations.[224] In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[225]

The special rules for Puerto Rico apply only with respect to the first eight taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2014.

REASONS FOR CHANGE

The Committee believes that, notwithstanding expiration of the Puerto Rico and possession tax credit and the Puerto Rico economic activity credit for taxable years beginning after 2005, the Code should grant a tax benefit for production in Puerto Rico. Consequently, the Committee believes that it is appropriate to treat Puerto Rico as part of the United States for purposes of the domestic production activities deduction.

EXPLANATION OF PROVISION

The provision extends the special domestic production activities rules for Puerto Rico to apply for the first ten taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2016.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2013.

[221] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

[222] Section 3401(a)(8)(C) excludes wages paid to United States citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.

[223] Sec. 7701(a)(9).

[224] Sec. 199(d)(8)(A).

[225] Sec. 199(d)(8)(B).

21. Extension of modification of tax treatment of certain payments to controlling exempt organizations (sec. 131 of the bill and sec. 512 of the Code)

PRESENT LAW

In general, organizations exempt from Federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[226] In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.[227]

Section 512(b)(13) provides rules regarding income derived by an exempt organization from a controlled subsidiary. In general, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business taxable income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt).

In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, "control" means ownership of more than 50 percent of the profits, capital, or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

For payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of section 512(b)(13) applies only to the portion of payments received or accrued in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of section 482 (*i.e.*, at arm's length).[228] A 20-percent penalty is imposed on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements. This special rule does not apply to payments received or accrued after December 31, 2013.

REASONS FOR CHANGE

The Committee believes that, for certain qualifying payments of rent, royalties, annuities, or interest by a controlled subsidiary to its exempt parent, it is appropriate to include in the parent's unrelated business taxable income only the portion of such payment that exceeds the amount that would have been paid in an arm's-

[226] Sec. 511.
[227] Sec. 512(b).
[228] Sec. 512(b)(13)(E).

length transaction. The Committee therefore believes it is desirable to extend the special rule for an additional two years.

EXPLANATION OF PROVISION

The provision extends the special rule for two years to payments received or accrued before January 1, 2016. Accordingly, under the provision, payments of rent, royalties, annuities, or interest by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of section 482 (*i.e.*, at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

EFFECTIVE DATE

The provision is effective for payments received or accrued after December 31, 2013.

22. Extension of treatment of certain dividends of regulated investment companies (sec. 132 of the bill and sec. 871(k) of the Code)

PRESENT LAW

In general

A regulated investment company ("RIC") is an entity that meets certain requirements (including a requirement that its income generally be derived from passive investments such as dividends and interest and a requirement that it distribute at least 90 percent of its income) and that elects to be taxed under a special tax regime. Unlike an ordinary corporation, an entity that is taxed as a RIC can deduct amounts paid to its shareholders as dividends. In this manner, tax on RIC income is generally not paid by the RIC but rather by its shareholders. Income of a RIC distributed to shareholders as dividends is generally treated as an ordinary income dividend by those shareholders, unless other special rules apply. Dividends received by foreign persons from a RIC are generally subject to gross-basis tax under sections 871(a) or 881, and the RIC payor of such dividends is obligated to withhold such tax under sections 1441 and 1442.

Under a temporary provision of prior law, a RIC that earned certain interest income that generally would not be subject to U.S. tax if earned by a foreign person directly could, to the extent of such net interest income, designate a dividend it paid as derived from such interest income for purposes of the treatment of a foreign RIC shareholder. A foreign person who is a shareholder in the RIC generally could treat such a dividend as exempt from gross-basis U.S. tax. Also, subject to certain requirements, the RIC was exempt from withholding the gross-basis tax on such dividends. Similar rules applied with respect to the designation of certain short-term capital gain dividends. However, these provisions relating to dividends with respect to interest income and short-term capital gain of the RIC have expired, and therefore do not apply to dividends with respect to any taxable year of a RIC beginning after December 31, 2013.[229]

REASONS FOR CHANGE

The Committee believes it is appropriate to extend for two years the provision that allows certain interest income and short-term capital gain of RICs to be designated as not subject to gross-basis tax, or to withholding of such tax, with respect to foreign investors in the RIC. The Committee believes the extension will promote greater certainty for foreign investors in RICs.

EXPLANATION OF PROVISION

The provision extends the rules exempting from gross-basis tax and from withholding of such tax the interest-related dividends and short-term capital gain dividends received from a RIC, to dividends with respect to taxable years of a RIC beginning before January 1, 2016.

EFFECTIVE DATE

The provision applies to dividends paid with respect to any taxable year of a RIC beginning after December 31, 2013.

23. Extension of RIC qualified investment entity treatment under FIRPTA (sec. 133 of the bill and secs. 897 and 1445 of the Code)

PRESENT LAW

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, although a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or active business requirements are met, a foreign person who sells a U.S. real property interest ("USRPI") is subject to tax at the same rates as a U.S. person, under the Foreign Investment in Real Property Tax Act ("FIRPTA") provisions codified in section 897 of the Code. Withholding tax is also imposed under section 1445.

A USRPI includes stock or a beneficial interest in any domestic corporation unless such corporation has not been a U.S. real property holding corporation (as defined) during the testing period. A USRPI does not include an interest in a domestically controlled "qualified investment entity." A distribution from a "qualified investment entity" that is attributable to the sale of a USRPI is also subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United States and the recipient foreign corporation or nonresident alien individual did not hold more than five percent of that class of stock or beneficial interest within the one-year period ending on the date of distribution.[230] Special rules apply to situations involving tiers of qualified investment entities.

[229] Secs. 871(k), 881(e), 1441(c)(12), 1441(a), and 1442.

[230] Sections 857(b)(3)(F), 852(b)(3)(E), and 871(k)(2)(E) require dividend treatment, rather than capital gain treatment, for certain distributions to which FIRPTA does not apply by reason of this exception. See also section 881(e)(2).

The term "qualified investment entity" includes a real estate investment trust ("REIT") and also includes a regulated investment company ("RIC") that meets certain requirements, although the inclusion of a RIC in that definition does not apply for certain purposes after December 31, 2013.[231]

REASONS FOR CHANGE

The Committee believes it is appropriate to extend the qualified investment entity treatment of RICs under FIRPTA for two years. The Committee believes the extension will promote greater certainty for foreign investors in RICs.

EXPLANATION OF PROVISION

The provision extends the inclusion of a RIC within the definition of a "qualified investment entity" under section 897 through December 31, 2015, for those situations in which that inclusion would otherwise have expired after December 31, 2013.

EFFECTIVE DATE

The provision is generally effective on January 1, 2014.

The provision does not apply with respect to the withholding requirement under section 1445 for any payment made before the date of enactment, but a RIC that withheld and remitted tax under section 1445 on distributions made after December 31, 2013 and before the date of enactment is not liable to the distributee with respect to such withheld and remitted amounts.

24. Extension of subpart F exception for active financing income (sec. 134 of the bill and secs. 953 and 954 of the Code)

PRESENT LAW

Under the subpart F rules,[232] 10-percent-or-greater 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, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (i.e., income derived from services performed for or on behalf of 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 real estate mortgage investment conduits ("REMICs"); (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in

[231] Section 897(h).
[232] Secs. 951–964.

lieu of dividends; and (8) amounts received under personal service contracts.

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.[233]

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, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").

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 to qualify for the active financing exceptions. 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 a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

[233] Prop. Treas. Reg. sec. 1.953–1(a).

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also 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. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

REASONS FOR CHANGE

The Committee believes that it is appropriate to extend the temporary provisions for an additional two years to provide certainty and to allow for business planning.

EXPLANATION OF PROVISION

The provision extends for two years (for taxable years beginning before January 1, 2016) the temporary exceptions from subpart F foreign personal holding company income, 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, as a securities dealer, or in the conduct of an insurance business.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

25. Extension of look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules (sec. 135 of the bill and sec. 954(c)(6) of the Code)

PRESENT LAW

In general

The rules of subpart F[234] require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation ("CFC") to include certain income of the CFC (referred to as "subpart F income") on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal holding company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor. In addition, subpart F income of a CFC does not include any item of income from sources within the United States that is effectively connected with the conduct by such CFC of a trade or business within the United States ("ECI") unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

The "look-thru rule"

Under the "look-thru rule" (sec. 954(c)(6)), dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the payor that is neither subpart F income nor treated as ECI. For this purpose, a related CFC is a CFC that controls or is controlled by the other CFC, or a CFC that is controlled by the same person or persons that control the other CFC. Ownership of more than 50 percent of the CFC's stock (by vote or value) constitutes control for these purposes.

The Secretary is authorized to prescribe regulations that are necessary or appropriate to carry out the look-thru rule, including such regulations as are necessary or appropriate to prevent the abuse of the purposes of such rule.

The look-thru rule applies to taxable years of foreign corporations beginning after December 31, 2005 and before January 1, 2014, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

[234] Secs. 951–964.

REASONS FOR CHANGE

The Committee believes that it is appropriate to extend the look-thru rule for two years to help U.S. companies with overseas operations compete more effectively with foreign firms.

EXPLANATION OF PROVISION

The provision extends for two years the application of the look-thru rule, to taxable years of foreign corporations beginning before January 1, 2016, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

26. Extension of exclusion of 100 percent of gain on certain small business stock (sec. 136 of the bill and sec. 1202 of the Code)

PRESENT LAW

In general

A taxpayer other than a corporation may exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years.[235] The amount of gain eligible for the exclusion by an individual with respect to the stock of any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) $10 million (reduced by the amount of gain eligible for exclusion in prior years). To qualify as a small business, when the stock is issued, the aggregate gross assets (i.e., cash plus aggregate adjusted basis of other property) held by the corporation may not exceed $50 million. The corporation also must meet certain active trade or business requirements.

The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax.[236] Seven percent of the excluded gain is an alternative minimum tax preference.[237]

Special rules for stock acquired after February 17, 2009, and before January 1, 2014

For stock acquired after February 17, 2009, and before September 28, 2010, the percentage exclusion for qualified small business stock sold by an individual is increased to 75 percent.

For stock acquired after September 27, 2010, and before January 1, 2014, the percentage exclusion for qualified small business stock sold by an individual is increased to 100 percent and the minimum tax preference does not apply.

[235] Sec. 1202.
[236] Sec. 1(h).
[237] Sec. 57(a)(7).

REASONS FOR CHANGE

The Committee believes that extending the increased exclusion and the elimination of the minimum tax preference will encourage and reward investment in qualified small business stock.

EXPLANATION OF PROVISION

The provision extends the 100-percent exclusion and the exception from minimum tax preference treatment for two years (for stock acquired before January 1, 2016).

EFFECTIVE DATE

The provision is effective for stock acquired after December 31, 2013.

27. Extension of basis adjustment to stock of S corporations making charitable contributions of property (sec. 137 of the bill and sec. 1367 of the Code)

PRESENT LAW

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.[238] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[239]

In the case of charitable contributions made in taxable years beginning before January 1, 2014, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For contributions made in taxable years beginning after December 31, 2013, the amount of the reduction is the shareholder's pro rata share of the fair market value of the contributed property.

REASONS FOR CHANGE

The Committee believes that the treatment of contributions of property by S corporations that applied to contributions made in certain taxable years beginning before January 1, 2014, is appropriate and should be extended.

EXPLANATION OF PROVISION

The provision extends the rule relating to the basis reduction on account of charitable contributions of property for two years to contributions made in taxable years beginning before January 1, 2016.

EFFECTIVE DATE

The provision applies to charitable contributions made in taxable years beginning after December 31, 2013.

[238] Sec. 1366(a)(1)(A).
[239] Sec. 1367(a)(2)(B).

28. Extension of reduction in S corporation recognition period for built-in gains tax (sec. 138 of the bill and sec. 1374 of the Code)

PRESENT LAW

In general

A "small business corporation" (as defined in section 1361(b)) may elect to be treated as an S corporation. Unlike C corporations, S corporations generally pay no corporate-level tax. Instead, items of income and loss of an S corporation pass through to its shareholders. Each shareholder takes into account separately its share of these items on its own income tax return.[240]

Under section 1374, a corporate level built-in gains tax, at the highest marginal rate applicable to corporations (currently 35 percent), is imposed on an S corporation's net recognized built-in gain[241] that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period, i.e., the 10-year period beginning with the first day of the first taxable year for which the S election is in effect.[242] If the taxable income of the S corporation is less than the amount of net recognized built-in gain in the year such built-in gain is recognized (for example, because of post-conversion losses), no tax under section 1374 is imposed on the excess of such built-in gain over taxable income for that year. However, the untaxed excess of net recognized built-in gain over taxable income for that year is treated as recognized built-in gain in the succeeding taxable year.[243] Treasury regulations provide that if a corporation sells an asset before or during the recognition period and reports the income from the sale using the installment method under section 453 during or after the recognition period, that income is subject to tax under section 1374.[244]

The built-in gains tax also applies to net recognized built-in gain attributable to any asset received by an S corporation from a C corporation in a transaction in which the S corporation's basis in the asset is determined (in whole or in part) by reference to the basis of such asset (or other property) in the hands of the C corporation.[245] In the case of such a transaction, the recognition period for any asset transferred by the C corporation starts on the date the asset was acquired by the S corporation in lieu of the beginning of the first taxable year for which the corporation was an S corporation.[246]

The amount of the built-in gains tax under section 1374 is treated as a loss by each of the S corporation shareholders in computing its own income tax.[247]

[240] Sec. 1366.

[241] Certain built-in income items are treated as recognized built-in gain for this purpose. Sec. 1374(d)(5).

[242] Sec. 1374(d)(7)(A). The 10-year period refers to ten calendar years from the first day of the first taxable year for which the corporation was an S corporation. Treas. Reg. sec. 1.1374–1(d). A regulated investment company (RIC) or a real estate investment trust (REIT) that was formerly a C corporation (or that acquired assets from a C corporation) generally is subject to the rules of section 1374 as if the RIC or REIT were an S corporation, unless the relevant C corporation elects "deemed sale" treatment. Treas. Reg. secs. 1.337(d)–7(b)(1) and (c)(1).

[243] Sec. 1374(d)(2).

[244] Treas. Reg. sec. 1.1374–4(h).

[245] Sec. 1374(d)(8).

[246] Sec. 1374(d)(8)(B).

[247] Sec. 1366(f)(2). Shareholders continue to take into account all items of gain and loss under section 1366.

Special rules for 2009, 2010, and 2011

For any taxable year beginning in 2009 and 2010, no tax was imposed on the net recognized built-in gain of an S corporation under section 1374 if the seventh taxable year in the corporation's recognition period preceded such taxable year.[248] Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under section 1374 if the seventh taxable year that the S corporation election was in effect preceded the taxable year beginning in 2009 or 2010.

For any taxable year beginning in 2011, no tax was imposed on the net recognized built-in gain of an S corporation under section 1374 if the fifth year in the corporation's recognition period preceded such taxable year.[249] Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under section 1374 if the S corporation election was in effect for five years preceding the taxable year beginning in 2011.

Special rules for 2012 and 2013

For taxable years beginning in 2012 and 2013, the term "recognition period" in section 1374, for purposes of determining the net recognized built-in gain, is applied by substituting a five-year period for the otherwise applicable 10-year period. Thus, for such taxable years, the recognition period is the five-year period beginning with the first day of the first taxable year for which the corporation was an S corporation (or beginning with the date of acquisition of assets if the rules applicable to assets acquired from a C corporation apply). If an S corporation with assets subject to section 1374 disposes of such assets in a taxable year beginning in 2012 or 2013 and the disposition occurs more than five years after the first day of the relevant recognition period, gain or loss on the disposition will not be taken into account in determining the net recognized built-in gain.

The rule requiring the excess of net recognized built-in gain over taxable income for a taxable year to be carried over and treated as recognized built-in gain in the succeeding taxable year applies only to gain recognized within the recognition period. Thus, for example, built-in gain recognized in a taxable year beginning in 2013, from a disposition in that year that occurs beyond the end of the temporary 5-year recognition period, will not be carried forward under the income limitation rule and treated as recognized built-in gain in the taxable year beginning in 2014 (after the temporary provision has expired and the recognition period is again 10 years).[250]

If an S corporation subject to section 1374 sells a built-in gain asset and reports the income from the sale using the installment method under section 453, the treatment of all payments received will be governed by the provisions of section 1374(d)(7) applicable to the taxable year in which the sale was made. Thus, for example, if an S corporation sold a built-in gain asset in 2008 in a sale occurring before or during the recognition period in effect at that time, and reported the gain using the installment method under

[248] Sec. 1374(d)(7)(B).
[249] Sec. 1374(d)(7)(C).
[250] Sec. 1374(d)(2)(B).

section 453, gain recognized under that method in 2012 or 2013 (including, for example, any gain under section 453B from a disposition of the installment obligation in those years)[251] is subject to tax under section 1374. On the other hand, if a corporation sold an asset in a taxable year beginning in 2012 or 2013, and the sale occurred beyond the end of the then-effective 5-year recognition period (but not beyond the end of the otherwise applicable 10-year recognition period), then gain reported using the installment method under section 453 in a taxable year beginning in 2014 (after the temporary provision expires) is not subject to tax under section 1374, because the sale was made after the end of the recognition period applicable to that sale. As a third example, if an S corporation sold an asset in a taxable year beginning in 2011, and no tax would have been imposed on the net recognized built-in gain from the sale under section 1374(d)(7)(B)(ii) because the fifth taxable year in the recognition period preceded such taxable year, then gain from such sale reported using the installment method under section 453 in a taxable year beginning in 2014 is not subject to tax under section 1374.[252]

REASONS FOR CHANGE

The Committee believes it is appropriate to extend the 5-year recognition period provision for two years, to promote business certainty.

EXPLANATION OF PROVISION

The provision extends, for taxable years beginning in 2014 and 2015, the special rules that applied to taxable years beginning in 2012 and 2013.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2013.

29. Extension of empowerment zone tax incentives (sec. 139 of the bill and secs. 1391 and 1397B of the Code)

PRESENT LAW

The Omnibus Budget Reconciliation Act of 1993 ("OBRA 93")[253] authorized the designation of nine empowerment zones ("Round I empowerment zones") to provide tax incentives for businesses to locate within certain targeted areas[254] designated by the Secretaries of the Department of Housing and Urban Development ("HUD") and the U.S. Department of Agriculture ("USDA"). The first empowerment zones were established in large rural areas and large cities. OBRA 93 also authorized the designation of 95 enterprise communities, which were located in smaller rural areas and cities.

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[251] Section 453B requires gain or loss to be recognized on disposition of an installment obligation and treated as gain or loss resulting from the sale or exchange of the property in respect of which the installment obligation was received.

[252] Report of the Senate Committee on Finance to Accompany S. 3521, the Family and Business Tax Cut Certainty Act of 2012, S. Rep. 112–208, August 28, 2012, pp 69–72.

[253] Pub. L. No. 103–66.

[254] The targeted areas are those that have pervasive poverty, high unemployment, and general economic distress, and that satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations.

For tax purposes, the areas designated as enterprise communities continued as such for the ten-year period starting in the beginning of 1995 and ending at the end of 2004.

The Taxpayer Relief Act of 1997[255] authorized the designation of two additional Round I urban empowerment zones, and 20 additional empowerment zones ("Round II empowerment zones"). The Community Renewal Tax Relief Act of 2000 ("2000 Community Renewal Act")[256] authorized a total of ten new empowerment zones ("Round III empowerment zones"), bringing the total number of authorized empowerment zones to 40.[257] In addition, the 2000 Community Renewal Act conformed the tax incentives that are available to businesses in the Round I, Round II, and Round III empowerment zones, and extended the empowerment zone incentives through December 31, 2009.[258] The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("TRUIRJCA") extended for two years, through December 31, 2011, the period for which the designation of an empowerment zone was in effect, thus extending for two years the empowerment zone tax incentives discussed below.[259] TRUIRJCA also extended for two years, through December 31, 2016, the exclusion of 60 percent of gain for qualified small business stock (of a corporation which is a qualified business entity) acquired on or before February 17, 2009. The American Taxpayer Relief Act of 2012 ("ATRA") extended the designation period and tax incentives for two additional years, through December 31, 2013.[260] ATRA also extended for two additional years, through December 31, 2018, the exclusion of 60 percent of gain for qualified small business stock (of a corporation which is a qualified business entity) acquired on or before February 17, 2009.

The tax incentives available within the designated empowerment zones include a Federal income tax credit for employers who hire qualifying employees (the "wage credit"), accelerated depreciation deductions on qualifying equipment, tax-exempt bond financing, deferral of capital gains tax on sale of qualified assets sold and replaced, and partial exclusion of capital gains tax on certain sales of qualified small business stock.

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[255] Pub. L. No. 105–34.

[256] Pub. L. No. 106–554.

[257] The urban part of the program is administered by HUD and the rural part of the program is administered by the USDA. The eight Round I urban empowerment zones are Atlanta, GA; Baltimore, MD, Chicago, IL; Cleveland, OH; Detroit, MI; Los Angeles, CA; New York, NY; and Philadelphia, PA/Camden, NJ. Atlanta relinquished its empowerment zone designation in Round III. The three Round I rural empowerment zones are Kentucky Highlands, KY; Mid-Delta, MI; and Rio Grande Valley, TX. The 15 Round II urban empowerment zones are Boston, MA; Cincinnati, OH; Columbia, SC; Columbus, OH; Cumberland County, NJ; El Paso, TX; Gary/Hammond/East Chicago, IN; Ironton, OH/Huntington, WV; Knoxville, TN; Miami/Dade County, FL; Minneapolis, MN; New Haven, CT; Norfolk/Portsmouth, VA; Santa Ana, CA; and St. Louis, Missouri/East St. Louis, IL. The five Round II rural empowerment zones are Desert Communities, CA; Griggs-Steele, ND; Oglala Sioux Tribe, SD; Southernmost Illinois Delta, IL; and Southwest Georgia United, GA. The eight Round III urban empowerment zones are Fresno, CA; Jacksonville, FL; Oklahoma City, OK; Pulaski County, AR; San Antonio, TX; Syracuse, NY; Tucson, AZ; and Yonkers, NY. The two Round III rural empowerment zones are Aroostook County, ME; and Futuro, TX.

[258] If an empowerment zone designation were terminated prior to December 31, 2009, the tax incentives would cease to be available as of the termination date.

[259] Pub. L. No. 111–312, sec. 753 (2010). In the case of a designation of an empowerment zone the nomination for which included a termination date which is December 31, 2009, termination shall not apply with respect to such designation if the entity which made such nomination amends the nomination to provide for a new termination date in such manner as the Secretary may provide.

[260] Pub. L. No. 112–240, sec. 327 (2013).

The following is a description of the tax incentives:

Wage credit

A 20-percent wage credit is available to employers for the first $15,000 of qualified wages paid to each employee (i.e., a maximum credit of $3,000 with respect to each qualified employee) who (1) is a resident of the empowerment zone, and (2) performs substantially all employment services within the empowerment zone in a trade or business of the employer.[261]

The wage credit rate applies to qualifying wages paid before January 1, 2012. Wages paid to a qualified employee who earns more than $15,000 are eligible for the wage credit (although only the first $15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the empowerment zone may claim the wage credit, regardless of whether the employer meets the definition of an "enterprise zone business."[262]

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[263] Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under section 51 or the welfare-to-work credit under section 51A.[264] In addition, the $15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.[265] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[266]

Increased section 179 expensing limitation

An enterprise zone business is allowed an additional $35,000 of section 179 expensing (for a total of up to $535,000 in 2010 and 2011)[267] for qualified zone property placed in service before January 1, 2012.[268] The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds $2,000,000.[269] The term "qualified zone property" is defined as depreciable tangible property (including buildings) provided that (i) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (ii) the original use of the property in an empowerment zone commences with the tax-

[261] Sec. 1396. The $15,000 limit is annual, not cumulative such that the limit is the first $15,000 of wages paid in a calendar year which ends with or within the taxable year.

[262] Secs. 1397C(b) and 1397C(c). However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B), including a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, or liquor store, or certain farming activities. In addition, wages are not eligible for the wage credit if paid to: (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

[263] Sec. 280C(a).

[264] Secs. 1396(c)(3)(A) and 51A(d)(2).

[265] Secs. 1396(c)(3)(B) and 51A(d)(2).

[266] Sec. 38(c)(2).

[267] The Small Business Jobs Act of 2010, Pub. L. No. 111–240, sec. 2021.

[268] Secs. 1397A, 1397D.

[269] Sec. 1397A(a)(2), 179(b)(2). For 2012 the limit is $500,000. For taxable years beginning after 2012, the limit is $200,000.

payer, and (iii) substantially all of the use of the property is in an empowerment zone in the active conduct of a trade or business by the taxpayer. Special rules are provided in the case of property that is substantially renovated by the taxpayer.

An enterprise zone business means any qualified business entity and any qualified proprietorship. A qualified business entity means, any corporation or partnership if for such year: (1) every trade or business of such entity is the active conduct of a qualified business within an empowerment zone; (2) at least 50 percent of the total gross income of such entity is derived from the active conduct of such business; (3) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within an empowerment zone; (4) a substantial portion of the intangible property of such entity is used in the active conduct of any such business; (5) a substantial portion of the services performed for such entity by its employees are performed in an empowerment zone; (6) at least 35 percent of its employees are residents of an empowerment zone; (7) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (8) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property.[270]

A qualified proprietorship is any qualified business carried on by an individual as a proprietorship if for such year: (1) at least 50 percent of the total gross income of such individual from such business is derived from the active conduct of such business in an empowerment zone; (2) a substantial portion of the use of the tangible property of such individual in such business (whether owned or leased) is within an empowerment zone; (3) a substantial portion of the intangible property of such business is used in the active conduct of such business; (4) a substantial portion of the services performed for such individual in such business by employees of such business are performed in an empowerment zone; (5) at least 35 percent of such employees are residents of an empowerment zone; (6) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (7) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to nonqualified financial property.[271]

A qualified business is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license or any business prohibited in connection with the employment credit.[272] In addition, the leasing of real property that is located within the empowerment zone is treated as a qualified business only if (1) the

[270] Sec. 1397C(b).

[271] Sec. 1397C(c).

[272] Sec. 1397C(d). Excluded businesses include any private or commercial golf course, country club, massage parlor, hot tub facility, sun tan facility, racetrack, or other facility used for gambling or any store the principal business of which is the sale of alcoholic beverages for off-premises consumption. Sec. 144(c)(6).

leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property is not a qualified business unless at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

Expanded tax-exempt financing for certain zone facilities

States or local governments can issue enterprise zone facility bonds to raise funds to provide an enterprise zone business with qualified zone property.[273] These bonds can be used in areas designated enterprise communities as well as areas designated empowerment zones. To qualify, 95 percent (or more) of the net proceeds from the bond issue must be used to finance: (1) qualified zone property whose principal user is an enterprise zone business, and (2) certain land functionally related and subordinate to such property.

The term enterprise zone business is the same as that used for purposes of the increased section 179 deduction limitation (discussed above) with certain modifications for start-up businesses. First, a business will be treated as an enterprise zone business during a start-up period if (1) at the beginning of the period, it is reasonable to expect the business to be an enterprise zone business by the end of the start-up period, and (2) the business makes bona fide efforts to be an enterprise zone business. The start-up period is the period that ends with the start of the first tax year beginning more than two years after the later of (1) the issue date of the bond issue financing the qualified zone property, and (2) the date this property is first placed in service (or, if earlier, the date that is three years after the issue date).[274]

Second, a business that qualifies as an enterprise zone business at the end of the start-up period must continue to qualify during a testing period that ends three tax years after the start-up period ends. After the three-year testing period, a business will continue to be treated as an enterprise zone business as long as 35 percent of its employees are residents of an empowerment zone or enterprise community.

The face amount of the bonds may not exceed $60 million for an empowerment zone in a rural area, $130 million for an empowerment zone in an urban area with zone population of less than 100,000, and $230 million for an empowerment zone in an urban area with zone population of at least 100,000.

Elective rollover of capital gain from the sale or exchange of any qualified empowerment zone asset

Taxpayers can elect to defer recognition of gain on the sale of a qualified empowerment zone asset[275] held for more than one year and replaced within 60 days by another qualified empowerment

[273] Sec. 1394.
[274] Sec. 1394(b)(3).
[275] The term "qualified empowerment zone asset" means any property which would be a qualified community asset (as defined in section 1400F, relating to certain tax benefits for renewal communities) if in section 1400F: (i) references to empowerment zones were substituted for references to renewal communities, (ii) references to enterprise zone businesses (as defined in section 1397C) were substituted for references to renewal community businesses, and (iii) the date of the enactment of this paragraph were substituted for "December 31, 2001" each place it appears. Sec. 1397B(b)(1)(A).

zone asset in the same zone.[276] The deferral is accomplished by reducing the basis of the replacement asset by the amount of the gain recognized on the sale of the asset.

A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock purchased for cash in an enterprise zone business), (2) a qualified community partnership interest (meaning a partnership interest acquired for cash in an enterprise zone business), and (3) qualified community business property (meaning tangible property originally used in a enterprise zone business by the taxpayer) that is purchased or substantially improved after the date of the enactment of this paragraph.

Partial exclusion of capital gains on certain small business stock

Generally, individuals may exclude a percentage of gain from the sale of certain small business stock acquired at original issue and held at least five years.[277] For stock acquired prior to February 18, 2009, or after December 31, 2013, the percentage is generally 50 percent, except that for empowerment zone stock the percentage is 60 percent for gain attributable to periods before January 1, 2019. For stock acquired after February 17, 2009, and before January 1, 2014, a higher percentage (either 75-percent or 100-percent) applies to all small business stock with no additional percentage for empowerment zone stock.[278]

Other tax incentives

Other incentives not specific to empowerment zones but beneficial to these areas include the work opportunity tax credit for employers based on the first year of employment of certain targeted groups, including empowerment zone residents (up to $2,400 per employee), and qualified zone academy bonds for certain public schools located in an empowerment zone, or expected (as of the date of bond issuance) to have at least 35 percent of its students receiving free or reduced lunches.

REASONS FOR CHANGE

The Committee believes that it continues to be important to provide tax incentives to individuals and businesses in empowerment zones and that it is appropriate to extend such incentives for an additional two years.

EXPLANATION OF PROVISION

The provision extends for two years, through December 31, 2015, the period for which the designation of an empowerment zone is in effect, thus extending for two years the empowerment zone tax incentives, including the wage credit, increased section 179 expensing for qualifying equipment, tax-exempt bond financing, and deferral of capital gains tax on sale of qualified assets replaced with other qualified assets. In the case of a designation of an empowerment zone the nomination for which included a termination date which is December 31, 2013, termination shall not apply with respect to such designation if the entity which made such nomination amends

[276] Sec. 1397B.
[277] Sec. 1202.
[278] Another provision extends the 100-percent exclusion to all small business stock acquired during 2014.

the nomination to provide for a new termination date in such manner as the Secretary may provide.

EFFECTIVE DATE

The provision applies to periods after December 31, 2013.

30. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands (sec. 140 of the bill and sec. 7652(f) of the Code)

PRESENT LAW

A $13.50 per proof gallon[279] excise tax is imposed on distilled spirits produced in or imported into the United States.[280] The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).[281]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[282] The amount of the cover over is limited under Code section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon before January 1, 2014).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[283] 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.[284] All of the amounts covered over are subject to the limitation.

REASONS FOR CHANGE

The Committee believes that, notwithstanding expiration of the Puerto Rico and possession tax credit and the Puerto Rico economic activity credit for taxable years beginning after 2005, the Code should grant a tax benefit for production in Puerto Rico. Consequently, the Committee believes that it is appropriate to treat Puerto Rico as part of the United States for purposes of the domestic production activities deduction.

EXPLANATION OF PROVISION

The provision suspends for two years the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover

[279] A proof gallon is a liquid gallon consisting of 50 percent alcohol. See sec. 5002(a)(10) and (11).

[280] Sec. 5001(a)(1).

[281] Secs. 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c).

[282] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

[283] Sec. 7652(e)(2).

[284] Secs. 7652(a)(3), (b)(3), and (e)(1).

over limitation of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2013 and before January 1, 2016. After December 31, 2015, the cover over amount reverts to $10.50 per proof gallon.

EFFECTIVE DATE

The provision is effective for articles brought into the United States after December 31, 2013.

31. Extension of American Samoa economic development credit (sec. 141 of the bill and sec. 119 of Pub. L. No. 109–432)

PRESENT LAW

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006 is allowed a credit based on the corporation's economic activity-based limitation with respect to American Samoa. The credit is not part of the Code but is computed based on the rules of sections 30A and 936. The credit is allowed for the first eight taxable years of a corporation that begin after December 31, 2005, and before January 1, 2014.

A corporation was an existing credit claimant with respect to a American Samoa if (1) the corporation was engaged in the active conduct of a trade or business within American Samoa on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit[285] in an election in effect for its taxable year that included October 13, 1995.[286] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the tax-

[285] For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b), 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936.

Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit generally expired for taxable years beginning after December 31, 2005.

[286] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

able year ending before the date on which that new line of business was added.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

For taxable years beginning after December 31, 2011 the credit rules are modified in two ways. First, domestic corporations with operations in American Samoa are allowed the credit even if those corporations are not existing credit claimants. Second, the credit is available to a domestic corporation (either an existing credit claimant or a new credit claimant) only if, in addition to satisfying all the present law requirements for claiming the credit, the corporation also has qualified production activities income (as defined in section 199(c) by substituting "American Samoa" for "the United States" in each place that latter term appears).

In the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, the credit applies to the first eight taxable years of the corporation which begin after December 31, 2005, and before January 1, 2014. For any other corporation, the credit applies to the first two taxable years of that corporation which begin after December 31, 2011 and before January 1, 2014.

REASONS FOR CHANGE

The Committee believes that, notwithstanding expiration of the possession tax credit for taxable years beginning after 2005, the U.S. Federal tax law should encourage economic activity in American Samoa. Consequently, the Committee believes it is appropriate to extend the American Samoa economic development credit.

EXPLANATION OF PROVISION

The provision extends the credit to apply (a) in the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, to the first ten taxable years of the corporation which begin after December 31, 2005, and before January 1, 2016 and (b) in the case of any other corporation, to the first four taxable years of the corporation which begin after December 31, 2011 and before January 1, 2016.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2013.

C. SUBTITLE C—ENERGY TAX EXTENDERS

1. Extension and modification of credit for nonbusiness energy property (sec. 151 of the bill and sec. 25C of the Code)

PRESENT LAW

Present law provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes.[287] A qualified energy efficiency improvement is any energy efficiency building envelope component (1) that meets or exceeds the prescriptive criteria for such a component established by the 2009 International Energy Conservation Code as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009[288] (or, in the case of windows, skylights and doors, and metal roofs with appropriate pigmented coatings or asphalt roofs with appropriate cooling granules, meets the Energy Star program requirements); (2) that is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) that reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling and which meet the prescriptive criteria for such material or system established by the 2009 International Energy Conservation Code, as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009;[289] (2) exterior windows (including skylights) and doors; and (3) metal or asphalt roofs with appropriate pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain for a dwelling.

Additionally, present law provides specified credits for the purchase of specific energy efficient property originally placed in service by the taxpayer during the taxable year. The allowable credit for the purchase of certain property is (1) $50 for each advanced main air circulating fan, (2) $150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $300 for each item of energy efficient building property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

[287] Sec. 25C.
[288] Pub. L. No. 111–5, February 17, 2009.
[289] *Ibid*.

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Energy-efficient building property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which achieves the highest efficiency tier established by the Consortium for Energy Efficiency, as in effect on January 1, 2009,[290] (3) a central air conditioner which achieves the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on January 1, 2009,[291] (4) a natural gas, propane, or oil water heater which has an energy factor of at least 0.82 or thermal efficiency of at least 90 percent, and (5) biomass fuel property.

Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants), grasses, residues, and fibers.

The credit is available for property placed in service prior to January 1, 2014. The maximum credit for a taxpayer for all taxable years is $500, and no more than $200 of such credit may be attributable to expenditures on windows.

The taxpayer's basis in the property is reduced by the amount of the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, expenditures which are made from subsidized energy financing are not taken into account. The term "subsidized energy financing" means financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

REASONS FOR CHANGE

The Committee recognizes that residential energy use for heating and cooling represents a large share of national energy consumption, and accordingly believes that measures to reduce heating and cooling energy demands have the potential to substantially reduce national energy consumption. The Committee further recognizes that many existing homes continue to be inadequately insulated and have inefficient heating, ventilation, and cooling equipment.

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[290] These standards are a seasonal energy efficiency ratio ("SEER") greater than or equal to 15, an energy efficiency ratio ("EER") greater than or equal to 12.5, and heating seasonal performance factor ("HSPF") greater than or equal to 8.5 for split heat pumps, and SEER greater than or equal to 14, EER greater than or equal to 12, and HSPF greater than or equal to 8.0 for packaged heat pumps.

[291] These standards are a SEER greater than or equal to 16 and EER greater than or equal to 13 for split systems, and SEER greater than or equal to 14 and EER greater than or equal to 12 for packaged systems.

Therefore, the Committee believes that a two year extension of the nonbusiness energy efficient property credit is an appropriate measure to continue to encourage upgrades to the energy efficiency of existing housing stock. The Committee further believes that adjustments of certain efficiency standards for qualifying property are necessary to ensure that the efficiency goals are achievable, but that significant energy savings above the norm are necessary in order to qualify for any credit.

EXPLANATION OF PROVISION

The provision extends the credit for two years, through December 31, 2015.

The provision expands qualifying property to include all roof and roof products that meet Energy Star program guidelines. The provision modifies certain efficiency standards for qualifying property, as follows:

(1) Windows, skylights, and doors must meet Energy Star version 6.0 standards.

(2) Natural gas, propane, or oil tankless water heaters must have an energy factor of at least 0.9 or a thermal efficiency of at least 90 percent. Natural gas, propane, or oil storage water heaters must have an energy factor of at least 0.8 or a thermal efficiency of at least 90 percent. Storage water heaters must have storage capacity of greater than 20 gallons but less than or equal to 55 gallons to claim the credit.

(3) Biomass fuel stoves must have thermal efficiency of 75 percent evaluated at the higher heating value and tested in accordance with Canadian Standards Administration B415.1 test protocol.

(4) Oil hot water boilers must have an annual fuel utilization efficiency not less than 90.

EFFECTIVE DATE

The provision is effective for property placed in service after December 31, 2013.

2. Extension of credit for 2-wheeled plug-in electric vehicles (sec. 152 of the bill and sec. 30D of the Code)

PRESENT LAW

A 10-percent credit is available for qualifying plug-in electric motorcycles and three-wheeled vehicles.[292] Qualifying two- or three-wheeled vehicles must have a battery capacity of at least 2.5 kilowatt-hours, be manufactured primarily for use on public streets, roads, and highways, and be capable of achieving speeds of at least 45 miles per hour. The maximum credit for any qualifying vehicle is $2,500. The credit is part of the general business credit. The credit is available for vehicles acquired before January 1, 2014.

REASONS FOR CHANGE

The Committee believes that further investments in advanced technology vehicles are necessary to transform automotive transportation in the United States to be cleaner, more fuel efficient,

[292] Sec. 30D(g).

and less reliant on petroleum fuels. For this reason, the Committee believes the credit for electric motorcycles should be extended.

EXPLANATION OF PROVISION

The provision extends the credit for electric motorcycles for two years, through December 31, 2015. The credit for electric three-wheeled vehicles is not extended.

EFFECTIVE DATE

The provision is effective for vehicles acquired after December 31, 2013.

3. Extension of second generation biofuel producer credit (sec. 153 of the bill and sec. 40(b)(6) of the Code)

PRESENT LAW

The second generation biofuel producer credit is a nonrefundable income tax credit for each gallon of qualified second generation biofuel fuel production of the producer for the taxable year. The amount of the credit per gallon is $1.01. The provision does not apply to fuel sold or used after December 31, 2013.

"Qualified second generation biofuel production" is any second generation biofuel which is produced by the taxpayer and which, during the taxable year, is: (1) sold by the taxpayer to another person (a) for use by such other person in the production of a qualified second generation biofuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or (c) who sells such second generation biofuel at retail to another person and places such cellulosic biofuel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (1)(a), (b), or (c).[293] Special rules apply for fuel derived from algae.

"Second generation biofuel" means any liquid fuel that (1) is produced in the United States and used as fuel in the United States, (2) is derived by or from qualified feedstocks and (3) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency ("EPA") under section 211 of the Clean Air Act. "Qualified feedstock" means any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis, and any cultivated algae, cyanobacteria or lemna. Second generation biofuel does not include fuels that (1) are more than four percent (determined by weight) water and sediment in any combination, (2) have an ash content of more than one percent (determined by weight), or (3) have an acid number greater than 25 ("unprocessed or excluded fuels"). It also does not include any alcohol with a proof of less than 150.

The second generation biofuel producer credit cannot be claimed unless the taxpayer is registered by the Internal Revenue Service ("IRS") as a producer of second generation biofuel. Second generation biofuel eligible for the section 40 credit is precluded from qualifying as biodiesel, renewable diesel, or alternative fuel for pur-

[293] In addition, for fuels derived from algae, cyanobacterial or lemna, a special rule provides that qualified second generation biofuel includes fuel that is sold by the taxpayer to another person for refining by such other person into a fuel that meets the registration requirements for fuels and fuel additives under section 211 of the Clean Air Act.

poses of the applicable income tax credit, excise tax credit, or payment provisions relating to those fuels.

Because it is a credit under section 40(a), the second generation biofuel producer credit is part of the general business credits in section 38. However, the credit can only be carried forward three taxable years after the termination of the credit. The credit is also allowable against the alternative minimum tax. Under section 87, the credit is included in gross income.

REASONS FOR CHANGE

The Committee believes that extending this production credit will encourage the industry to continue development of these fuels and allow time for business planning.

EXPLANATION OF PROVISION

The provision extends the credit for two years, through December 31, 2015.

EFFECTIVE DATE

The provision is effective for qualified second generation biofuel production after December 31, 2013.

4. Extension of incentives for biodiesel and renewable diesel (secs. 154 and 311(a) and (e) of the bill and secs. 40A, 6426 and 6427(e) of the Code)

PRESENT LAW

Biodiesel

Present law provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[294] The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The amount of the biodiesel fuels credit is includible in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit does not apply to fuel sold or used after December 31, 2013.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the EPA under section 211 of the Clean Air Act (42 U.S.C. sec. 7545) and (2) the requirements of the American Society of Testing and Materials ("ASTM") D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, camelina, or animal fats.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer or importer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.

[294] Sec. 40A.

Biodiesel mixture credit

The biodiesel mixture credit is $1.00 for each gallon of biodiesel (including agri-biodiesel) used by the taxpayer in the production of a qualified biodiesel mixture. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing such mixture. The sale or use must be in the trade or business of the taxpayer and is to be taken into account for the taxable year in which such sale or use occurs. No credit is allowed with respect to any casual off-farm production of a qualified biodiesel mixture.

Per IRS guidance a mixture need only contain 1/10th of one percent of diesel fuel to be a qualified mixture.[295] Thus, a qualified biodiesel mixture can contain 99.9 percent biodiesel and 0.1 percent diesel fuel.

Biodiesel credit (B–100)

The biodiesel credit is $1.00 for each gallon of biodiesel that is not in a mixture with diesel fuel (100 percent biodiesel or B–100) and which during the taxable year is (1) used by the taxpayer as a fuel in a trade or business or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle.

Small agri-biodiesel producer credit

The Code provides a small agri-biodiesel producer income tax credit, in addition to the biodiesel and biodiesel mixture credits. The credit is 10 cents per gallon for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year. The agri-biodiesel must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified biodiesel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such agri-biodiesel at retail to another person and places such agri-biodiesel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[296] The credit is $1.00 for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. A biodiesel mixture is a mixture of biodiesel and diesel fuel that (1) is sold by the taxpayer producing such mixture to any person for use as a fuel or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.[297]

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[295] Notice 2005–62, I.R.B. 2005–35, 443 (2005). "A biodiesel mixture is a mixture of biodiesel and diesel fuel containing at least 0.1 percent (by volume) of diesel fuel. Thus, for example, a mixture of 999 gallons of biodiesel and 1 gallon of diesel fuel is a biodiesel mixture."

[296] Sec. 6426(c).

[297] Sec. 6426(c)(4).

The credit is not available for any sale or use for any period after December 31, 2013. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

Payments with respect to biodiesel fuel mixtures

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit.[298] The biodiesel fuel mixture credit must first be taken against tax liability for taxable fuels. To the extent the biodiesel fuel mixture credit exceeds such tax liability, the excess may be received as a payment. Thus, if the person has no section 4081 liability, the credit is refundable. The Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2013.

Renewable diesel

"Renewable diesel" is liquid fuel that (1) is derived from biomass (as defined in section 45K(c)(3)), (2) meets the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act, and (3) meets the requirements of the ASTM D975 or D396, or equivalent standard established by the Secretary. ASTM D975 provides standards for diesel fuel suitable for use in diesel engines. ASTM D396 provides standards for fuel oil intended for use in fuel-oil burning equipment, such as furnaces. Renewable diesel also includes fuel derived from biomass that meets the requirements of a Department of Defense specification for military jet fuel or an ASTM specification for aviation turbine fuel.

For purposes of the Code, renewable diesel is generally treated the same as biodiesel. In the case of renewable diesel that is aviation fuel, kerosene is treated as though it were diesel fuel for purposes of a qualified renewable diesel mixture. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.[299] The incentive for renewable diesel is $1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expired after December 31, 2013.

REASONS FOR CHANGE

The Committee believes that extending the biodiesel and renewable diesel incentives through 2015 will give the industry certainty and allow for business planning.

EXPLANATION OF PROVISION

The provision extends the income tax credit, excise tax credit and payment provisions for biodiesel and renewable diesel for two years (through December 31, 2015).

In light of the retroactive nature of the provision, as it relates to fuel sold or used in 2014, the provision creates a special rule to address claims regarding excise credits and claims for payment associated with periods occurring during 2014. In particular the pro-

[298] Sec. 6427(e).
[299] Secs. 40A(f), 6426(c), and 6427(e).

vision directs the Secretary to issue guidance within 30 days of the date of enactment. Such guidance is to provide for a one-time submission of claims covering periods occurring during 2014. The guidance is to provide for a 180-day period for the submission of such claims (in such manner as prescribed by the Secretary) to begin no later than 30 days after such guidance is issued. Such claims shall be paid by the Secretary of the Treasury not later than 60 days after receipt. If the claim is not paid within 60 days of the date of the filing, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621 of the Code.

EFFECTIVE DATE

The provision is effective for sales and uses after December 31, 2013.

5. Extension and modification of credit for the production of Indian coal (sec. 155 of the bill and sec. 45(e)(10) of the Code)

PRESENT LAW

A credit is available for the production of Indian coal sold to an unrelated third party from a qualified facility for a seven-year period beginning January 1, 2006, and ending December 31, 2013. The amount of the credit for Indian coal is $1.50 per ton for the first four years of the seven-year period and $2.00 per ton for the last three years of the seven-year period. Beginning in calendar years after 2006, the credit amounts are indexed annually for inflation using 2005 as the base year. The credit amount for 2014 is $2.317 per ton.

A qualified Indian coal facility is a facility placed in service before January 1, 2009, that produces coal from reserves that on June 14, 2005, were owned by a Federally recognized tribe of Indians or were held in trust by the United States for a tribe or its members.

The credit is a component of the general business credit,[300] allowing excess credits to be carried back one year and forward up to 20 years. The credit is also subject to the alternative minimum tax.

REASONS FOR CHANGE

The Committee believes that supporting the development of energy resources on Indian lands encourages both national energy independence and economic growth in traditionally disadvantaged areas. For this reason the Committee believes the credit for Indian coal should be extended.

EXPLANATION OF PROVISION

The provision extends the credit for the production of Indian coal for two years (through December 31, 2015). The placed-in-service date for qualified facilities is not extended, but the provision clarifies that qualified Indian coal facilities that are leased or subleased after December 31, 2008, do not lose their eligibility as a result of such lease or sublease.

[300] Sec. 38(b)(8).

EFFECTIVE DATE

The provision is effective for Indian coal produced after December 31, 2013.

6. Extension of credits with respect to facilities producing energy from certain renewable resources (sec. 156 of the bill and secs. 45 and 48 of the Code)

PRESENT LAW

Renewable electricity production credit

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the "renewable electricity production credit").[301] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

SUMMARY OF CREDIT FOR ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES

Eligible electricity production activity (sec. 45)	Credit amount for 2014 [1] (cents per kilowatt-hour)	Expiration [2]
Wind	2.3	December 31, 2013.
Closed-loop biomass	2.3	December 31, 2013.
Open-loop biomass (including agricultural livestock waste nutrient facilities).	1.1	December 31, 2013.
Geothermal	2.3	December 31, 2013.
Solar (pre-2006 facilities only)	2.3	December 31, 2005.
Small irrigation power	1.1	December 31, 2013.
Municipal solid waste (including landfill gas facilities and trash combustion facilities).	1.1	December 31, 2013.
Qualified hydropower	1.1	December 31, 2013.
Marine and hydrokinetic	1.1	December 31, 2013.

[1] In general, the credit is available for electricity produced during the first 10 years after a facility has been placed in service.
[2] Expires for property the construction of which begins after this date.

Election to claim energy credit in lieu of renewable electricity production credit

A taxpayer may make an irrevocable election to have certain property which is part of a qualified renewable electricity production facility be treated as energy property eligible for a 30 percent investment credit under section 48. For this purpose, qualified facilities are facilities otherwise eligible for the renewable electricity production credit with respect to which no credit under section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the renewable electricity production credit. The eligible basis for the investment credit for taxpayers making this election is the basis of the depreciable (or amortizable) prop-

[301] Sec. 45. In addition to the renewable electricity production credit, section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

erty that is part of a facility capable of generating electricity eligible for the renewable electricity production credit.

REASONS FOR CHANGE

The Committee believes that additional incentives for the production of electricity from renewable resources will help limit the environmental consequences of continued reliance on power generated using fossil fuels.

EXPLANATION OF PROVISION

The provision extends the renewable electricity production credit and the election to claim the energy credit in lieu of the electricity production credit for two years, through December 31, 2015.

EFFECTIVE DATE

The provision is effective on January 1, 2014.

7. Extension of credit for energy-efficient new homes (sec. 157 of the bill and sec. 45L of the Code)

PRESENT LAW

Present law provides a credit to an eligible contractor for each qualified new energy-efficient home that is constructed by the eligible contractor and acquired by a person from such eligible contractor for use as a residence during the taxable year. To qualify as a new energy-efficient home, the home must be: (1) a dwelling located in the United States, (2) substantially completed after August 8, 2005, and (3) certified in accordance with guidance prescribed by the Secretary to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30-percent or 50-percent reduction in energy usage, compared to a comparable dwelling constructed in accordance with the standards of chapter 4 of the 2006 International Energy Conservation Code as in effect (including supplements) on January 1, 2006, and any applicable Federal minimum efficiency standards for equipment. With respect to homes that meet the 30-percent standard, one-third of such 30-percent savings must come from the building envelope, and with respect to homes that meet the 50-percent standard, one-fifth of such 50-percent savings must come from the building envelope.

Manufactured homes that conform to Federal manufactured home construction and safety standards are eligible for the credit provided all the criteria for the credit are met. The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home.

The credit equals $1,000 in the case of a new home that meets the 30-percent standard and $2,000 in the case of a new home that meets the 50-percent standard. Only manufactured homes are eligible for the $1,000 credit.

In lieu of meeting the standards of chapter 4 of the 2006 International Energy Conservation Code, manufactured homes certified by a method prescribed by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program are eligible for the $1,000 credit provided criteria (1) and (2), above, are met.

The credit applies to homes that are purchased prior to January 1, 2014. The credit is part of the general business credit.

REASONS FOR CHANGE

The Committee recognizes that residential energy use for heating and cooling represents a large share of national energy consumption, and accordingly believes that measures to reduce heating and cooling energy requirements have the potential to substantially reduce national energy consumption. The Committee further recognizes that the most cost-effective time to achieve home energy efficiency is when the home is under construction. Accordingly, the Committee believes that a two year extension of the energy efficient new homes credit is a cost effective incentive to reduce national energy consumption.

EXPLANATION OF PROVISION

The provision extends the credit to homes that are acquired prior to January 1, 2016.

EFFECTIVE DATE

The provision is effective for homes acquired after December 31, 2013.

8. Extension of special allowance for second generation biofuel plant property (sec. 158 of the bill and sec. 168(l) of the Code)

PRESENT LAW

Present law[302] allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified second generation biofuel plant property. In order to qualify, the property generally must be placed in service before January 1, 2014.[303]

Qualified second generation biofuel plant property means depreciable property used in the U.S. solely to produce any liquid fuel that (1) is derived from qualified feedstocks, and (2) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency ("EPA") under section 211 of the Clean Air Act.[304] Qualified feedstocks means any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis[305] and any cultivated algae, cyanobacteria, or lemna.[306] Second generation biofuel does not include any alcohol with a proof of less than 150 or certain unprocessed fuel.[307] Unprocessed fuels are fuels that (1) are more than four percent (determined by weight) water and sediment in any combination, (2) have an ash content of more than one percent (determined by weight), or (3) have an acid number greater than 25.[308]

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[302] Sec. 168(l).

[303] Sec. 168(l)(2)(D).

[304] Secs. 168(l)(2)(A) and 40(b)(6)(E).

[305] For example, lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis includes bagasse (from sugar cane), corn stalks, and switchgrass.

[306] Sec. 40(b)(6)(F).

[307] Sec. 40(b)(6)(E)(ii) and (iii).

[308] Sec. 40(b)(6)(E)(iii).

The additional first-year 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.[309] The additional first-year depreciation deduction is subject to the general rules regarding whether an item is subject to capitalization under section 263A. 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.[310] In addition, there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies.[311] A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.[312]

In order for property to qualify for the additional first-year depreciation deduction, it must meet the following requirements: (1) the original use of the property must commence with the taxpayer on or after December 20, 2006; and (2) the property must be (i) acquired by purchase (as defined under section 179(d)) by the taxpayer after December 20, 2006, and (ii) placed in service before January 1, 2014.[313] Property does not qualify if a binding written contract for the acquisition of such property was in effect on or before December 20, 2006.

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 December 20, 2006, and the property is placed in service before January 1, 2014 (and all other requirements are met).[314] 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.

Property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103 is not eligible for the additional first-year depreciation deduction.[315] Recapture rules apply if the property ceases to be qualified second generation biofuel plant property.[316]

Property with respect to which the taxpayer has elected 50 percent expensing under section 179C is not eligible for the additional first-year depreciation deduction.[317]

REASONS FOR CHANGE

The Committee acknowledges that encouraging the manufacturing of biofuels (including algae-based fuels) in the United States is important for fostering innovative new technology, encouraging energy independence, supporting the commercial production of these fuels, and creating manufacturing jobs in the United States.

[309] Sec. 168(l)(5).
[310] Sec. 168(l)(1)(B).
[311] Secs. 168(l)(5) and 168(k)(2)(G).
[312] Sec. 168(l)(3)(D).
[313] Sec. 168(l)(2).
[314] Sec. 168(l)(4) and 168(k)(2)(E).
[315] Sec. 168(l)(3)(C).
[316] Sec. 168(l)(6).
[317] Sec. 168(l)(7).

The Committee also believes that this provision helps to spur new investment in the production of chemicals using biomass as a feedstock, thereby reducing the use of petroleum in chemical production.

EXPLANATION OF PROVISION

The provision extends the present law special depreciation allowance for two years, to qualified second generation biofuel plant property placed in service prior to January 1, 2016.

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2013.

9. Extension and modification of energy efficient commercial buildings deduction (sec. 159 of the bill and sec. 179D of the Code)

PRESENT LAW

In general

Code section 179D provides an election under which a taxpayer may take an immediate deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property is defined as property (1) which is installed on or in any building located in the United States that is within the scope of Standard 90.1–2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America ("ASHRAE/IESNA"), (2) which is installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope, and (3) which is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building which meets the minimum requirements of Standard 90.1–2001 (as in effect on April 2, 2003). The deduction is limited to an amount equal to $1.80 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service.

Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, will promulgate regulations that describe methods of calculating and verifying energy and power costs using qualified computer software based on the provisions of the 2005 California Nonresidential Alternative Calculation Method Approval Manual or, in the case of residential property, the 2005 California Residential Alternative Calculation Method Approval Manual.

The Secretary is granted authority to prescribe procedures for the inspection and testing for compliance of buildings that are comparable, given the difference between commercial and residential buildings, to the requirements in the Mortgage Industry National

Accreditation Procedures for Home Energy Rating Systems.[318] Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the Secretary for such purposes.

For energy-efficient commercial building property expenditures made by a public entity, such as public schools, the deduction may be allocated to the person primarily responsible for designing the property in lieu of the public entity.

If a deduction is allowed under this section, the basis of the property is reduced by the amount of the deduction.

The deduction is effective for property placed in service prior to January 1, 2014.

Partial allowance of deduction

System-specific deductions

In the case of a building that does not meet the overall building requirement of 50-percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is $0.60 per square foot for each separate system.

Interim rules for lighting systems

In general, in the case of system-specific partial deductions, no deduction is allowed until the Secretary establishes system-specific targets.[319] However, in the case of lighting system retrofits, until such time as the Secretary issues final regulations, the system-specific energy savings target for the lighting system is deemed to be met by a reduction in lighting power density of 40 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 of ASHRAE/IESNA Standard 90.1–2001. Also, in the case of a lighting system that reduces lighting power density by 25 percent, a partial deduction of 30 cents per square foot is allowed. A pro-rated partial deduction is allowed in the case of a lighting system that reduces lighting power density between 25 percent and 40 percent. Certain lighting level and

[318] See IRS Notice 2006–52, 2006–1 C.B. 1175, June 2, 2006; IRS 2008–40, 2008–14 I.R.B. 725 March 11, 2008.

[319] IRS Notice 2008–40, Supra, set a target of a 10-percent reduction in total energy and power costs with respect to the building envelope, and 20 percent each with respect to the interior lighting system and the heating, cooling, ventilation and hot water systems. IRS Notice 2012–26 (2012–17 I.R.B. 847 April 23, 2012) established new targets of 10-percent reduction in total energy and power costs with respect to the building envelope, 25 percent with respect to the interior lighting system and 15 percent with respect to the heating, cooling, ventilation and hot water systems, effective beginning March 12, 2012. The targets from Notice 2008–40 may continue to be used until December 31, 2013, but only the new targets of Notice 2012–26 will be available under any extension of section 179D beyond December 31, 2013.

lighting control requirements must also be met in order to qualify for the partial lighting deductions under the interim rule.

REASONS FOR CHANGE

The Committee recognizes that commercial buildings consume a significant amount of energy resources and that reductions in commercial energy use have the potential to significantly reduce national energy consumption. The Committee believes that a two year extension of this provision will continue to encourage construction of buildings that are significantly more energy efficient than the norm, thereby contributing to decreased energy consumption. For the purpose of achieving parity with other government entities, the Committee believes that tribal governments should be allowed to allocate the deduction to the person primarily responsible for designing the property, in the same manner as is currently allowed for other public property. In order to extend the reach of this provision and further reduce energy consumption, the Committee also believes that it is appropriate to allow non-profits (as defined in section 501(c)(3)) to allocate the deduction in this manner. Finally, given that nine years have passed since the adoption of the energy efficient commercial building deduction, the Committee believes it is necessary to update the efficiency standards that must be met in order to qualify for the deduction.

EXPLANATION OF PROVISION

The provision extends the deduction for two years, through December 31, 2015. Additionally, the provision permits tribal governments and non-profits (as defined in section 501(c)(3)) to allocate the deduction to the person primarily responsible for designing the property, in the same manner as is allowed for public property. Finally, the provision increases the efficiency standards for property placed in service after December 31, 2014, such that qualifying buildings are determined relative to the ASHRAE/IESNA 90.1–2007 standards.

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2013.

10. Extension of special rule for sales or dispositions to implement FERC or State electric restructuring policy for qualified electric utilities (sec. 160 of the bill and sec. 451(i) of the Code)

PRESENT LAW

A taxpayer selling property generally realizes gain to the extent the sales price (and any other consideration received) exceeds the taxpayer's basis in the property.[320] The realized gain is subject to current income tax[321] unless the recognition of the gain is deferred or excluded from income under a special tax provision.[322]

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions rat-

[320] See sec. 1001.
[321] See secs. 61 and 451.
[322] See, *e.g.*, secs. 453, 1031 and 1033.

ably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period[323] (the "reinvestment property").[324] If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by a qualified electric utility to an independent transmission company prior to January 1, 2014.[325] A qualified electric utility is defined as an electric utility, which as of the date of the qualifying electric transmission transaction, is vertically integrated in that it is both (1) a transmitting utility (as defined in the Federal Power Act[326]) with respect to the transmission facilities to which the election applies, and (2) an electric utility (as defined in the Federal Power Act[327]).[328]

In general, an independent transmission company is defined as: (1) an independent transmission provider[329] approved by the Federal Energy Regulatory Commission ("FERC"); (2) a person (i) who the FERC determines under section 203 of the Federal Power Act[330] (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider no later than four years after the close of the taxable year in which the transaction occurs; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).[331]

Exempt utility property is defined as: (1) property used in the trade or business of (i) generating, transmitting, distributing, or selling electricity or (ii) producing, transmitting, distributing, or selling natural gas; or (2) stock in a controlled corporation whose principal trade or business consists of the activities described in (1).[332] Exempt utility property does not include any property that is located outside of the United States.[333]

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the reinvestment property may be pur-

[323] The applicable period for a taxpayer to reinvest the proceeds is four years after the close of the taxable year in which the qualifying electric transmission transaction occurs.

[324] Sec. 451(i).

[325] Sec. 451(i)(3).

[326] Sec. 3(23), 16 U.S.C. sec. 796, defines "transmitting utility" as any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency that owns or operates electric power transmission facilities that are used for the sale of electric energy at wholesale.

[327] Sec. 3(22), 16 U.S.C. sec. 796, defines "electric utility" as any person or State agency (including any municipality) that sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

[328] Sec. 451(i)(6).

[329] For example, a regional transmission organization, an independent system operator, or an independent transmission company.

[330] 16 U.S.C. sec. 824b.

[331] Sec. 451(i)(4).

[332] Sec. 451(i)(5).

[333] Sec. 451(i)(5)(C).

chased by any member of the affiliated group (in lieu of the taxpayer).[334]

REASONS FOR CHANGE

The Committee believes that the "unbundling" of electric transmission assets held by vertically integrated utilities, with the transmission assets ultimately placed under the ownership or control of independent transmission providers (or other similarly-approved operators), continues to be an important policy. To continue facilitating the implementation of this policy, the Committee believes it is appropriate to continue to assist taxpayers in moving forward with industry restructuring by continuing to provide a tax deferral for gain associated with certain dispositions of electric transmission assets. The Committee believes this provision will encourage the sale of transmission property from electric utilities to independent transmission companies to improve transmission management and facilitate competitive transmission markets.

EXPLANATION OF PROVISION

The provision extends for two years the treatment under the present-law deferral provision to sales or dispositions by a qualified electric utility that occur prior to January 1, 2016.

EFFECTIVE DATE

The provision applies to dispositions after December 31, 2013.

11. Extension of excise tax credits relating to certain fuels (alternative fuel and alternative fuel mixtures (including hydrogen)) (sec. 161 of the bill and sec. 6426 and 6427(e) of the Code)

PRESENT LAW

Fuel excise taxes

Fuel excise taxes are imposed on taxable fuel (gasoline, diesel fuel or kerosene) under section 4081. In general, these fuels are taxed when removed from a refinery, terminal rack, upon entry into the United States, or upon sale to an unregistered person. A back-up tax under section 4041 is imposed on previously untaxed fuel and alternative fuel used or sold for use as fuel in a motor vehicle or motorboat to the supply tank of a highway vehicle. In general, the rates of tax are 18.3 cents per gallon (or in the case of compressed natural gas 18.3 cents per gasoline gallon equivalent), and in the case of liquefied natural gas, and liquid fuel derived from coal or biomass, 24.3 cents per gallon.

Alternative fuel and alternative fuel mixture credits and payments

The Code provides two per-gallon excise tax credits with respect to alternative fuel: the alternative fuel credit, and the alternative fuel mixture credit. For this purpose, the term "alternative fuel" means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process ("coal-to-liquids"), com-

[334] Sec. 451(i)(7).

pressed or liquefied gas derived from biomass, or liquid fuel derived from biomass. Such term does not include ethanol, methanol, or biodiesel.

For coal-to-liquids produced after December 30, 2009, the fuel must be certified as having been derived from coal produced at a gasification facility that separates and sequesters 75 percent of such facility's total carbon dioxide emissions.

The alternative fuel credit is allowed against section 4041 liability, and the alternative fuel mixture credit is allowed against section 4081 liability. Neither credit is allowed unless the taxpayer is registered with the Secretary. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents[335] of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat, sold for use in aviation or so used by the taxpayer.

The alternative fuel mixture credit is 50 cents per gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. An "alternative fuel mixture" is a mixture of alternative fuel and taxable fuel (gasoline, diesel fuel or kerosene) that contains at least 1⁄10 of one percent taxable fuel. The mixture must be sold by the taxpayer producing such mixture to any person for use as a fuel, or used by the taxpayer producing the mixture as a fuel. The credits expired after December 31, 2013 (September 30, 2014 for liquefied hydrogen).

A person may file a claim for payment equal to the amount of the alternative fuel credit (but not the alternative fuel mixture credit). The alternative fuel credit must first be applied to the applicable excise tax liability under section 4041 or 4081, and any excess credit may be taken as a payment. These payment provisions generally also expire after December 31, 2013. With respect to liquefied hydrogen, the payment provisions expire after September 30, 2014.

For purposes of the alternative fuel credit, alternative fuel mixture credit and related payment provisions, "alternative fuel" does not include fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp.

REASONS FOR CHANGE

The Committee believes it is appropriate to extend the incentives for alternative fuel to provide certainty to the industry and allow for business planning.

EXPLANATION OF PROVISION

The provision extends the alternative fuel credit and related payment provisions, and the alternative fuel mixture credit through December 31, 2015 (including those related to liquefied hydrogen).

In light of the retroactive nature of the provision, as it relates to alternative fuel sold or used in 2014, the provision creates a special rule to address claims regarding excise credits and claims for payment associated with periods occurring during 2014. In particular the provision directs the Secretary to issue guidance within

[335] "Gasoline gallon equivalent" means, with respect to any nonliquid alternative fuel (for example, compressed natural gas), the amount of such fuel having a Btu (British thermal unit) content of 124,800 (higher heating value).

30 days of the date of enactment. Such guidance is to provide for a one-time submission of claims covering periods occurring during 2014. The guidance is to provide for a 180-day period for the submission of such claims (in such manner as prescribed by the Secretary) to begin no later than 30 days after such guidance is issued. Such claims shall be paid by the Secretary of the Treasury not later than 60 days after receipt. If the claim is not paid within 60 days of the date of the filing, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621 of such Code.

The provision, as it relates to biodiesel and renewable diesel, is described above in connection with section 304 of the bill "Incentives for Biodiesel and Renewable Diesel."

EFFECTIVE DATE

The provision is generally effective for fuel sold or used after December 31, 2013. As it relates to liquefied hydrogen, the provision is effective for fuels sold or used after September 30, 2014.

TITLE II—PROVISIONS EXPIRING IN 2014

A. SUBTITLE A—ENERGY TAX EXTENDERS

1. Extension of credit for new qualified fuel cell motor vehicles (sec. 201 of the bill and sec. 30B of the Code)

PRESENT LAW

A credit is available through 2014 for new vehicles propelled by chemically combining oxygen with hydrogen and creating electricity. The base credit is $4,000 for vehicles weighing 8,500 pounds or less. Heavier vehicles can get up to a $40,000 credit, depending on their weight. An additional $1,000 to $4,000 credit is available to cars and light trucks to the extent their fuel economy exceeds the 2002 base fuel economy set forth in the Code. The credit is available to vehicles purchased before January 1, 2015.

In general, the credit is allowed to the vehicle owner, including the lessor of a vehicle subject to a lease. In certain cases, where the vehicle is owned by a tax-exempt entity, government, or foreign person, and is not subject to lease, the credit may be claimed by the seller of the vehicle so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

REASONS FOR CHANGE

The Committee believes that further investments in advanced technology vehicles are necessary to transform automotive transportation in the United States to be cleaner, more fuel efficient, and less reliant on petroleum fuels. For the reasons, the Committee believes the credit for fuel cell vehicles should be extended.

EXPLANATION OF PROVISION

The provision extends the provision for one year, for vehicles purchased before January 1, 2016.

EFFECTIVE DATE

The provision is effective for vehicles purchased after December 31, 2014.

2. Extension of alternative fuel vehicle refueling property (sec. 202 of the bill and sec. 30C of the Code)

PRESENT LAW

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer.[336] The credit may not exceed $30,000 per taxable year per location, in the case of qualified refueling property used in a trade or business and $1,000 per taxable year per location, in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel or electricity into the fuel tank or battery of a motor vehicle propelled by such fuel or electricity, but only if the storage or dispensing of the fuel or electricity is at the point of delivery into the fuel tank or battery of the motor vehicle. The original use of such property must begin with the taxpayer.

Clean-burning fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for one year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2014. In the case of hydrogen refueling property, the property must be placed in service before January 1, 2015.

REASONS FOR CHANGE

The Committee believes that further investments in advanced technology vehicles and related infrastructure are necessary to transform automotive transportation in the United States to be cleaner, more fuel efficient, and less reliant on petroleum fuels. For

[336] Sec. 30C.

the reasons, the Committee believes the credit for alternative fuel refueling property should be extended.

EXPLANATION OF PROVISION

The provision extends the 30-percent credit for alternative fuel refueling property for two years (one year in the case of hydrogen refueling property, the credit which continues under present law through 2014), through December 31, 2015.

EFFECTIVE DATE

The provision is effective for property placed in service after December 31, 2013.

B. SUBTITLE B—EXTENDERS RELATING TO MULTIEMPLOYER DEFINED BENEFIT PENSION PLANS

1. Multiemployer defined benefit plans (secs. 251–252 of the bill and sec. 221(c) of the Pension Protection Act of 2006, secs. 431–432 of the Code, and secs. 304–305 of ERISA)

PRESENT LAW

Multiemployer plans

A multiemployer plan is a plan to which more than one unrelated employer contributes, that is established pursuant to one or more collective bargaining agreements, and that meets other requirements as specified by the Secretary of Labor. Multiemployer plans are governed by a board of trustees consisting of an equal number of employer and employee representatives. In general, the level of contributions to a multiemployer plan is specified in the applicable collective bargaining agreements, and the level of plan benefits is established by the plan trustees.

Multiemployer defined benefit plans are subject to minimum funding requirements under the Code and the Employee Retirement Income Security Act of 1974 ("ERISA").[337] Certain changes were made to the funding requirements for multiemployer plans by the Pension Protection Act of 2006 ("PPA").[338] Changes made by PPA are effective for plan years beginning after 2007.

General funding requirements for multiemployer plans

Minimum required contributions

In connection with the funding requirements for a multiemployer plan, a notional account called a "funding standard account" is maintained, to which specific charges and credits (including plan contributions) are made for each plan year the multiemployer plan is maintained. The minimum required contribution for a plan year is the amount, if any, needed so that the accumulated credits to the funding standard account as of that plan year are not less than the accumulated charges (i.e., so the funding standard account does not have a negative balance). If, as of the close of a plan year, accumulated charges to the funding standard account exceed credits, the

[337] Secs. 412 and 431–432 of the Code and secs. 302 and 304–305 of ERISA. Additional rules apply to multiemployer plans that are in reorganization status or insolvent under sections 418–418E of the Code and sections 4241–4245 of ERISA.

[338] Pub. L. No. 109–280.

plan has an "accumulated funding deficiency" equal to the amount of the excess.[339] For example, if, as of a plan year, the balance of charges to the funding standard account would be $200,000 without any contributions, then a minimum contribution equal to that amount is required to meet the minimum funding standard for the year (i.e., to prevent an accumulated funding deficiency). If credits to the funding standard account exceeds charges, a "credit balance" results. The amount of the credit balance, increased with interest, reduces future required contributions.

Funding method; charges and credits to the funding standard account

In the case of a multiemployer plan, an acceptable actuarial cost method (referred to as a funding method) must be used to determine the elements included in its funding standard account for a year. Generally, a funding method breaks up the cost of benefits under the plan into annual charges to the funding standard account consisting of two elements for each plan year. These elements are referred to as: (1) normal cost; and (2) supplemental cost.

The plan's normal cost for a plan year generally represents the cost of future benefits allocated to the year by the funding method used by the plan for current employees and, under some funding methods, for separated employees. Specifically, it is the amount actuarially determined that would be required as a contribution by the employer for the plan year in order to maintain the plan if the plan had been in effect from the beginning of service of the included employees and if the costs for prior years had been paid, and all assumptions (e.g., interest and mortality) had been fulfilled. A plan's normal cost for a plan year is charged to the funding standard account for that year.

The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets. The most common supplemental cost is that attributable to past service liability, which represents the cost of future benefits under the plan: (1) on the date the plan is first effective; or (2) on the date a plan amendment increasing plan benefits is first effective. Other supplemental costs may be attributable to net experience losses (e.g., worse than expected investment returns or actuarial experience), losses from changes in actuarial assumptions, and amounts necessary to make up funding deficiencies for which a waiver was obtained. Supplemental costs are amortized (i.e., recognized for funding purposes) over a specified number of years (generally 15 years) by annual charges to the funding standard account over that period.

Factors that result in a supplemental loss can alternatively result in a gain that is recognized by annual credits to the funding standard account over a 15-year amortization period (in addition to a credit for contributions made each the plan year). These include a reduction in plan liabilities as a result of a plan amendment decreasing plan benefits, net experience gains (e.g., better than ex-

[339] An excise tax under section 4971 may apply in the case of an accumulated funding deficiency.

pected investment returns or actuarial experience), and gains from changes in actuarial assumptions.

Extensions of amortization periods

Before and after PPA, the sponsor of a multiemployer plan (that is, the board of trustees) may obtain from the Secretary of the Treasury ("Secretary") an extension of up to 10 years of the amortization periods applicable in determining charges to the funding standard account. The extension may be granted by the Secretary if the Secretary determines that (1) the extension would carry out the purposes of ERISA and would provide adequate protection for participants under the plan and (2) the failure to permit the extension would (a) result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation and (b) be adverse to the interests of plan participants in the aggregate. The sponsor must also provide satisfactory evidence that notice of the request, including certain information, has been provided to plan participants and beneficiaries, any employee organization representing participants, and the Pension Benefit Guaranty Corporation ("PBGC").

Under PPA, in addition to an amortization extension described above, the sponsor of a multiemployer plan certified as meeting certain criteria may apply for an amortization extension of up to five years that is required to be approved by the Secretary (referred to as an automatic amortization extension). Included with the application must be a certification by the plan's actuary that (1) absent the extension, the plan would have an accumulated funding deficiency in the current plan year and any of the nine succeeding plan years, (2) the sponsor has adopted a plan to improve the plan's funding status, (3) taking into account the extension, the plan is projected to have sufficient assets to timely pay its expected benefit liabilities and other anticipated expenditures, and (4) the required notice described above has been provided. The period of any automatic amortization extension reduces the 10-year period for which an extension described above may be granted by the Secretary. The provision relating to automatic amortization extensions does not apply with respect to any application submitted after December 31, 2014.[340]

Shortfall funding method

Certain plans may elect to determine the required charges to the funding standard account under the shortfall funding method. Under this method, the charges are computed on the basis of an estimated number of units of service or production for which a certain amount per unit is to be charged. The difference between the net amount charged under this method and the net amount that otherwise would have been charged for the same period is a shortfall loss or gain that is amortized over subsequent plan years.

In general, the funding method used with respect to a multiemployer plan may be changed only with approval of the Secretary. However, under PPA, certain multiemployer plans may adopt, use or cease using the shortfall funding method and the adoption, use,

[340] Sec. 431(d)(1)(C) of the Code and sec. 304(d)(1)(C) of ERISA.

or cessation of use is deemed approved by the Secretary.[341] Plans are eligible if (1) the plan has not used the shortfall funding method during the five-year period ending on the day before the date the plan is to use the shortfall funding method; and (2) the plan is not operating under an amortization extension and did not operate under such an extension during the five-year period. In general, plan amendments increasing benefit liabilities of the plan cannot be adopted while the shortfall funding method is in use. Deemed approval of a multiemployer plan's adoption, use, or cessation of use of the shortfall funding method does not apply to plan years beginning after December 31, 2014.[342]

Additional requirements relating to endangered or critical status

In general

Under PPA, additional funding rules apply to a multiemployer defined benefit pension plan that is in endangered or critical status.[343] In connection with these rules, not later than the 90th day of each plan year, the actuary for any multiemployer plan must certify to the Secretary and to the sponsor whether or not the plan is in endangered or critical status for the plan year. If a plan is certified to be in endangered or critical status, notice of the endangered or critical status must be provided within 30 days after the date of certification to plan participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor. Additional notice requirements apply in the case of a plan certified to be in critical status.

A multiemployer plan is in endangered status if the plan is not in critical status and, as of the beginning of the plan year, (1) the plan's funded percentage for the plan year is less than 80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage of plan assets over accrued liability of the plan. A plan that meets the requirements of both (1) and (2) is treated as in seriously endangered status.

A multiemployer plan is in critical status for a plan year if as of the beginning of the plan year:

1. The funded percentage of the plan is less than 65 percent and the sum of (A) the market value of plan assets, plus (B) the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),

2. (A) The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or (B) the plan is projected to have an accumulated

[341] Sec. 201(b) of PPA.
[342] Sec. 221(c) of PPA.
[343] Sec. 432 of the Code as enacted by sec. 212 of PPA, and sec. 305 of ERISA, as enacted by sec. 202 of PPA.

funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extension,

3. (A) The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, (B) the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and (C) the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

4. The sum of (A) the market value of plan assets, plus (B) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

Requirements during endangered or critical status

Various requirements apply to a plan in endangered or critical status, including adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status. In addition, restrictions on certain plan amendments, benefit increases, and reductions in employer contributions apply during certain periods.

In the case of a multiemployer plan in critical status, additional required contributions (referred to as employer surcharges) apply until the adoption of a collective bargaining that is consistent with the rehabilitation plan. In addition, employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules (and the related excise tax), provided that a rehabilitation plan is adopted and followed.[344] Moreover, subject to notice requirements, some benefits that would otherwise be protected from elimination or reduction may be eliminated or reduced in accordance with the rehabilitation plan.[345]

A funding improvement plan is a plan consisting of actions, including options or a range of options, to be proposed to the bargaining parties, formulated to provide, based on reasonably anticipated experience and reasonable actuarial assumptions, for the attainment by the plan of certain requirements within a certain period (generally 10 years), referred to as the funding improvement period. The funding improvement plan must provide that, by the

[344] Code sec. 4971(g)(1)(A).

[345] The rules for multiemployer plans in critical status include the elimination or reduction of "adjustable benefits," which include some benefits that would otherwise be protected from elimination or reduction under the anticutback rules under section 411(d)(6) of the Code and section 204(g) of ERISA.

end of the funding improvement period, the plan will have a certain required increase in the funded percentage and no accumulated funding deficiency for any plan year during the funding improvement period.

In general, a rehabilitation plan is a plan consisting of actions, including options or a range of options to be proposed to the bargaining parties, formulated, based on reasonable anticipated experience and reasonable actuarial assumptions, to enable the plan to cease to be in critical status within a certain period (generally 10 years), referred to as the rehabilitation period, and may include reductions in plan expenditures (including plan mergers and consolidations), reductions in future benefits accruals or increases in contributions, if agreed to by the bargaining parties, or any combination of such actions. A rehabilitation plan must provide annual standards for meeting the requirements of the rehabilitation. The plan must also include the schedules required to be provided to the bargaining parties.

If the sponsor of a plan in critical status determines that, based on reasonable actuarial assumptions and upon exhaustion of all reasonable measures, the plan cannot reasonably be expected to emerge from critical status by the end of the rehabilitation period, the plan must include reasonable measures to emerge from critical status at a later time or to forestall possible insolvency. In such case, the plan must set forth alternatives considered, explain why the plan is not reasonably expected to emerge from critical status by the end of the rehabilitation period, and specify when, if ever, the plan is expected to emerge from critical status in accordance with the rehabilitation plan.

The sponsor of the multiemployer plan must update the funding improvement or rehabilitation plan annually.

In the case of a failure to meet the requirements applicable to a multiemployer plan in endangered or critical status, the plan actuary, plan sponsor, or employers required to contribute to the plan may be subject to an excise tax under the Code or a civil penalty under ERISA.[346]

Sunset of endangered and critical rules

The rules relating to endangered and critical status generally do not apply to plan years beginning after December 31, 2014.[347] However, if a multiemployer plan is operating under a funding improvement or rehabilitation plan for its last plan year beginning before January 1, 2015, that is, for its 2014 plan year, the multiemployer plan must continue to operate under the funding improvement or rehabilitation plan during any period after December 31, 2014, that the funding improvement or rehabilitation plan is in effect, and all of the Code and ERISA provisions relating to the operation of the funding improvement or rehabilitation plan continue in effect during that period.

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[346] Code sec. 4971(g) and ERISA sec. 502(c)(8). In addition, certain failures are treated as a failure to file an annual report with respect to the multiemployer plan, subject to a civil penalty under ERISA.

[347] Sec. 221(c) of PPA.

REASONS FOR CHANGE

The endangered and critical rules under PPA were enacted in response to concerns that some multiemployer pension plans were facing current or near-term funding issues. The rules provide a structure for identifying troubled plans and require specific measures to be taken to address funding issues. For plans in critical status, the rules also provide a greater range of measures that may be taken to address these issues. Since the enactment of PPA, these rules have been used by a number of plans to begin addressing their funding issues. The Committee therefore considers it important to leave the endangered and critical rules in place. At the same time, the purpose of the PPA sunset was, in part, to provide an opportunity for the Congress to assess the efficacy of the rules and to consider whether changes are warranted. An extension of the sunset continues the availability of the endangered and critical rules, as well as providing additional time for congressional action.

EXPLANATION OF PROVISION

Under the provision, the PPA provisions relating to automatic extensions of amortization periods, deemed approval of a multiemployer plan's adoption, use, or cessation of use of the shortfall funding method, and rules relating to endangered and critical status are extended for one year. Thus, the provision relating to automatic amortization extensions does not apply with respect to any application submitted after December 31, 2015. Deemed approval of a multiemployer plan's adoption, use, or cessation of use of the shortfall funding method, and the rules relating to endangered and critical status do not apply to plan years beginning after December 31, 2015. However, if a multiemployer plan is operating under a funding improvement or rehabilitation plan for its last plan year beginning before January 1, 2016, that is, for its 2015 plan year, the multiemployer plan must continue to operate under the funding improvement or rehabilitation plan during any period after December 31, 2015, that the funding improvement or rehabilitation plan is in effect, and all of the Code and ERISA provisions relating to the operation of the funding improvement or rehabilitation plan continue in effect during that period.

EFFECTIVE DATE

The provision relating to automatic extensions of amortization periods applies to applications submitted to the Secretary after December 31, 2014. The provision relating to deemed approval of a multiemployer plan's adoption, use, or cessation of use of the shortfall funding method and the rules relating to endangered and critical status applies to plan years beginning after December 31, 2014.

TITLE III—REVENUE PROVISIONS

1. Penalty for failure to meet the due diligence requirements for the child tax credit (sec. 301 of the bill and sec. 6695 of the Code)

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[348] and the earned income credit ("EIC").[349] 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).

An individual may claim a child tax credit of $1,000 for each qualifying child under the age of 17,[350] provided that the child is a citizen, national, or resident of the United States.[351] 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.[352] 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)[353] 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

[348] Sec. 24.
[349] Sec. 32.
[350] Sec. 24(a).
[351] Sec. 24(c).
[352] Sec. 24(b).
[353] Sec. 24(d).

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.

Diligence required by preparers' returns for EIC claimants

Under Section 6695(g) of the Code, a penalty of $500 may be imposed on a person who, as a tax return preparer,[354] prepares a tax return for a taxpayer claiming the EIC, 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.[355] 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 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.[356] 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.[357] The enhanced duties of due diligence required with respect to the EIC do not extend to other refundable credits.

REASONS FOR CHANGE

The Committee believes that more thorough efforts by return preparers are important to improving child tax credit compliance. Specifically, the Committee believes that imposing a due diligence requirement discourages preparers from advising or assisting tax-

[354] 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.
[355] Treas. Reg. sec. 1.6695–2(b).
[356] If the return preparer electronically files the return or claim for the taxpayer, the Form 8867 is filed electronically with the return. If the prepared return or claim 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.
[357] Treas. Reg. sec. 1.6695–2(d).

payers in claiming credits that cannot be sustained, thus reducing the incidence of erroneous claims.

EXPLANATION OF PROVISION

The provision 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 provision anticipates that the EIC checklist currently 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 provision is effective for tax years ending after December 31, 2014.

2. 100 percent continuous levy authority on payments to Medicare providers and suppliers (sec. 302 of the bill and sec. 6331 of the Code)

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.[358] Generally, the IRS is entitled to seize a taxpayer's property by levy if a Federal tax lien has attached to such property,[359] the property is not exempt from levy,[360] and the IRS has provided both notice of intention to levy[361] 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")[362] at least 30 days before the levy is made. A levy on salary or wages generally is continuously in effect until released.[363] 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.[364]

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.[365]

The CDP notice (and pre-levy CDP hearing) is not required if: (1) the Secretary finds that collection would be jeopardized by delay;

[358] 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.
[359] *Ibid*.
[360] Sec. 6334.
[361] Sec. 6331(d).
[362] Sec. 6330. The notice and the hearing are referred to collectively as the CDP requirements.
[363] Secs. 6331(e) and 6343.
[364] Sec. 6321.
[365] Secs. 6331(d)(3), 6861.

(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, however, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy.[366]

Federal payment levy program

To help the IRS collect taxes more effectively, the Taxpayer Relief Act of 1997[367] 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.[368] 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.

Payments to Medicare providers

In 2008, the Government Accountability Office ("GAO") found that over 27,000 Medicare providers (i.e., about six percent of all such providers) owed more than $2 billion of tax debt, consisting largely of individual income and payroll taxes.[369] As of 2008, the Centers for Medicare & Medicaid Services ("CMS") had not incorporated most of its Medicare payments into the continuous levy program, despite the IRS authority to continuously levy up to 15 percent of these payments. The GAO noted that CMS officials promised to incorporate about 60 percent of all Medicare fee-for-service payments into the levy program by October 2008 and the remaining 40 percent in the next several years. Following the GAO study, Congress directed CMS to participate in the FPLP and ensure that all Medicare provider and supplier payments are processed through it, in specified graduated percentages, by the end of

[366] Sec. 6330(f).
[367] Pub. L. No. 105–34.
[368] Sec. 6331(h)(3). The word "property" was added to "goods or services" in section 301 of the "3% Withholding Repeal and Job Creation Act," Pub. L. No. 112–56.
[369] Government Accountability Office, *Medicare: Thousands of Medicare Providers Abuse the Federal Tax System* (GAO–08–618), June 13, 2008.

fiscal year 2011.[370] CMS has since incorporated its payments into the continuous levy program to ensure that it collects delinquent tax debts from Medicare providers as authorized.

REASONS FOR CHANGE

It has been reported that many thousands of Medicare providers abuse the Federal tax system.[371] Consequently, the Committee believes that is it appropriate to increase the permissible percentage of payments to a Medicare provider subject to levy to 100 percent.

EXPLANATION OF PROVISION

The provision allows the Secretary to levy up to 100 percent of a payment to a Medicare provider to collect unpaid taxes.

EFFECTIVE DATE

The provision is effective for payments made six months after the date of enactment.

3. Exclusion from gross income of certain clean coal power grants (sec. 303 of the bill)

PRESENT LAW

Section 402 of the Energy Policy Act of 2005 provides criteria for Federal financial assistance under the Clean Coal Power Initiative. To the extent this financial assistance comes in the form of a grant, award, or allowance, it must generally be included in income under section 61 of the Internal Revenue Code (the "Code").

Corporate taxpayers may be eligible to exclude such financial assistance from gross income as a contribution of capital under section 118 of the Code. The basis of any property acquired by reason of such a contribution of capital must be reduced by the amount of the contribution. This exclusion is not available to non-corporate taxpayers.

REASONS FOR CHANGE

The Committee believes that Federal financial assistance under the Clean Coal Power Initiative should be excludable from the income of investors in order to make such assistance as effective as possible in encouraging clean coal power. In addition, the Committee believes that a corresponding basis reduction is necessary in all cases to prevent any unintended double benefit under the incentive.

EXPLANATION OF PROVISION

With respect to eligible non-corporate recipients, the provision excludes from gross income and alternative minimum taxable income any grant, award, or allowance made pursuant to section 402 of the Energy Policy Act of 2005. The provision requires that, to the extent the grant, award or allowance is related to depreciable property, the adjusted basis is reduced by the amount excluded from in-

[370] Medicare Improvement for Patients and Providers Act of 2008, Pub. L. No. 110–275, sec. 189.

[371] Government Accountability Office, *Medicare: Thousands of Medicare Providers Abuse the Federal Tax System* (GAO–08–618), June 13, 2008.

come under the provision. The provision requires eligible non-corporate recipients to pay an upfront payment to the Federal government equal to 1.18 percent of the value of the grant, award, or allowance.

Under the provision, eligible non-corporate recipients are defined as (1) any recipient (other than a corporation) of any grant, award, or allowance made pursuant to Section 402 of the Energy Policy Act of 2005 that (2) makes the upfront 1.18-percent payment, where (3) the grant, award, or allowance would have been excludable from income by reason of Code section 118 if the taxpayer had been a corporation. In the case of a partnership, the eligible non-corporate recipients are the partners.

EFFECTIVE DATE

The provision is effective for payments received in taxable years beginning after December 31, 2011.

4. Reform of rules related to qualified tax collection contracts, and special compliance personnel program (secs. 304 and 305 of the bill and sec. 6306 and new sec. 6307 of the Code)

PRESENT LAW

Code section 6306 permits the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities of any type [372] and to arrange payment of those taxes by the taxpayers. There must be an assessment pursuant to section 6201 in order for there to be an outstanding tax liability. An assessment is the formal recording of the taxpayer's tax liability that fixes the amount payable. An assessment must be made before the IRS is permitted to commence enforcement actions to collect the amount payable. In general, an assessment is made at the conclusion of all examination and appeals processes within the IRS.[373]

Several steps are involved in the deployment of private debt collection companies. First, the private debt collection company contacts the taxpayer by letter.[374] If the taxpayer's last known address is incorrect, the private debt collection company searches for the correct address. Second, the private debt collection company telephones the taxpayer to request full payment.[375] If the taxpayer cannot pay in full immediately, the private debt collection company offers the taxpayer an installment agreement providing for full payment of the taxes over a period of as long as five years. If the taxpayer is unable to pay the outstanding tax liability in full over a five-year period, the private debt collection company obtains financial information from the taxpayer and will provide this information to the IRS for further processing and action by the IRS.

[372] This provision generally applies to any type of tax imposed under the Internal Revenue Code.

[373] An amount of tax reported as due on the taxpayer's tax return is considered to be self-assessed. If the IRS determines that the assessment or collection of tax will be jeopardized by delay, it has the authority to assess the amount immediately (sec. 6861), subject to several procedural safeguards.

[374] The provision requires that the IRS disclose confidential taxpayer information to the private debt collection company. Section 6103(n) permits disclosure of returns and return information for "the providing of other services . . . for purposes of tax administration."

[375] The private debt collection company is not permitted to accept payment directly. Payments are required to be processed by IRS employees.

The Code specifies several procedural conditions under which the provision would operate. First, provisions of the Fair Debt Collection Practices Act apply to the private debt collection company. Second, taxpayer protections that are statutorily applicable to the IRS are also made statutorily applicable to the private sector debt collection companies. In addition, taxpayer protections that are statutorily applicable to IRS employees are made statutorily applicable to employees of private sector debt collection companies. Third, subcontractors are prohibited from having contact with taxpayers, providing quality assurance services, and composing debt collection notices; any other service provided by a subcontractor must receive prior approval from the IRS.

The Code creates a revolving fund from the amounts collected by the private debt collection companies. The private debt collection companies will be paid out of this fund. The Code prohibits the payment of fees for all services in excess of 25 percent of the amount collected under a tax collection contract.

The Code also provides that up to 25 percent of the amount collected may be used for IRS collection enforcement activities. The law also requires Treasury to provide a biennial report to the Committee on Finance and the Committee on Ways and Means. The report is to include, among other items, a cost benefit analysis, the impact of the debt collection contracts on collection enforcement staff levels in the IRS, and an evaluation of contractor performance.

The Omnibus Appropriations Act of 2009 (the "Act"), which made appropriations for the fiscal year ending September 30, 2009, included a provision stating that none of the funds made available in the Act could be used to fund or administer section 6306.[376] Around the same time, the IRS announced that the IRS would not renew its contracts with private debt collection agencies.[377]

REASONS FOR CHANGE

The Committee believes that the use of private debt collection agencies will help facilitate the collection of taxes owed to the Government. The Committee also believes that the safeguards it has incorporated, such as narrowing the class of receivables subject to collection and giving priority to previously approved contractors, will protect taxpayers' rights and privacy.

The Committee believes that the increased collections that may result from the use of private debt collection agencies for limited classes of debts should be used to improve the ability of the Government to handle compliance matters overall. By funding the hiring and training of special compliance personnel, the Committee believes the IRS can establish a cadre of well-trained personnel who perform various compliance functions while protecting taxpayers' rights.

EXPLANATION OF PROVISION

Qualified tax collection contracts

The provision requires the Secretary to enter into qualified tax collection contracts for the collection of inactive tax receivables. In-

[376] Pub. L. No. 111–8, March 11, 2009.
[377] IR–2009–19, March 5, 2009.

active tax receivables are defined as any tax receivable (i) removed from the active inventory for lack of resources or inability to locate the taxpayer, (ii) for which more than 1/3 of the applicable limitations period has lapsed and no IRS employee has been assigned to collect the receivable; and (iii) for which, a receivable has been assigned for collection but more than 365 days have passed without interaction with the taxpayer or a third party for purposes of furthering the collection. Tax receivables are defined as any outstanding assessment which the IRS includes in potentially collectible inventory.

The provision designates certain tax receivables as not eligible for collection under qualified tax collection contracts, specifically a contract that: (i) is subject to a pending or active offer-in-compromise or installment agreement; (ii) is classified as an innocent spouse case; (iii) involves a taxpayer identified by the Secretary as being (a) deceased, (b) under the age of 18, (c) in a designated combat zone, or (d) a victim of identity theft; (iv) is currently under examination, litigation, criminal investigation, or levy; or (v) is currently subject to a proper exercise of a right of appeal. The provision grants authority to the Secretary to prescribe procedures for taxpayers in presidentially declared disaster areas to request relief from immediate collection measures under the provision.

The provision requires the Secretary to give priority to private collection contractors and debt collection centers currently approved by the Treasury Department's Financial Management Service on the schedule required under section 3711(g) of title 31 of the United States Code, to the extent appropriate to carry out the purposes of the provision.

The provision adds an additional exception to section 6103 to allow contractors to identify themselves as such and disclose the nature, subject, and reason for the contact. Disclosures are permitted only in situations and under conditions approved by the Secretary.

The provision requires the Secretary to prepare two reports for the House Committee on Ways and Means and the Senate Committee on Finance. The first report is required annually and due not later than 90 days after each fiscal year and is required to include: (i) the total number and amount of tax receivables provided to each contractor for collection under this section, (ii) the total amounts collected by and installment agreements resulting from the collection efforts of each contactor and the collection costs incurred by the IRS; (iii) the impact of such contacts on the total number and amount of unpaid assessments, and on the number and amount of assessments collected by IRS personnel after initial contact by a contractor, (iv) the amount of fees retained by the Secretary under subsection (e) and a description of the use of such funds; and (v) a disclosure safeguard report in a form similar to that required under section 6103(p)(5).

The second report is required biannually and is required to include: (i) an independent evaluation of contactor performance; and (ii) a measurement plan that includes a comparison of the best practices used by private collectors to the collection techniques used by the IRS and mechanisms to identify and capture information on successful collection techniques used by the contractors that could be adopted by the IRS.

Special compliance personnel program

The provision requires that the amount that, under current law, is to be retained and used by the IRS for collection enforcement activities under section 6306 of the Code be instead used to fund a newly created special compliance personnel program. The provision also requires the Secretary to establish an account for the hiring, training, and employment of special compliance personnel. No other source of funding the program is permitted, and funds deposited in the special account are restricted to use for the program, including reimbursement of the IRS and other agencies for the cost of administering the qualified debt collection program and all costs associated with employment of special compliance personnel and the retraining and reassignment of other personnel as special compliance personnel. Special compliance personnel are individuals employed by the IRS to serve either as revenue officers performing field collection functions, or as persons operating the automated collection system.

The provision requires the Secretary to prepare annually a report for the House Committee on Ways and Means and the Senate Committee on Finance, to be submitted no later than March of each year. In the report, the Secretary is to describe for the preceding fiscal year accounting of all funds received in the account, administrative and program costs, number of special compliance personnel hired and employed as well as actual revenue collected by such personnel. Similar information for the current and following fiscal year, using both actual and estimated amounts, is required.

EFFECTIVE DATE

Qualified tax collection contracts

The provision relating to qualified tax collection contracts applies to tax receivables identified by the Secretary after the date of enactment. The requirement to give priority to certain private collection contractors and debt collection centers applies to contracts and agreements entered into after the date of enactment, and the new exception to section 6103 applies to disclosures made after the date of enactment. The requirement of the reports to Congress is effective on the date of enactment.

Special compliance personnel program

The provision relating to the special compliance personnel program applies to amounts collected and retained by the Secretary after date of enactment.

5. Exclusion of dividends from controlled foreign corporations from the definition of personal holding company income for purposes of the personal holding company rules (sec. 306 of the bill and sec. 543 of the Code)

PRESENT LAW

Personal holding company tax

In addition to the regular corporate tax, an additional tax is imposed on a corporation that is a personal holding company. The tax is an amount equal to the maximum rate of tax on qualified dividends of individuals (currently 20 percent), multiplied by the corporation's undistributed personal holding company income above a dollar threshold.[378] A personal holding company is a closely held corporation at least 60 percent of the adjusted ordinary gross income (as defined) of which is personal holding company income.[379] Personal holding company income includes dividends, interest, certain rents, and other generally passive investment income.[380]

Controlled foreign corporations

In general, the U.S. does not impose tax on the income of a foreign corporation unless and until that income is distributed to U.S. shareholders. However, the rules of subpart F[381] provide an exception for certain passive or readily movable income of a foreign corporation that, for a period of at least 30 days during the taxable year, is more than 50-percent owned by U.S. shareholders each of which owns at least 10 percent of the corporate stock after applying attribution rules (a controlled foreign corporation). The pro rata share of such corporate earnings is currently included as income of the 10-percent (or greater) shareholders that hold their stock on the last day of the taxable year. Except as otherwise provided for specific purposes of the Code, the inclusions are not treated as dividends. When the earnings are distributed to the U.S. shareholders, they are not again subject to tax.[382]

When a controlled foreign corporation distributes money or other property to a U.S. shareholder out of its earnings and profits not previously included in the income of the shareholder, the amount of money or fair market value of the property is included in gross income as a dividend.[383]

REASONS FOR CHANGE

The Committee believes that dividends paid by a controlled foreign corporation to a 10-percent U.S. shareholder, out of the controlled foreign corporation's earnings and profits that were not treated as passive income inclusions to the shareholder, are attributable to active business income of the controlled foreign corporation. Accordingly, it is appropriate to exclude these dividends from personal holding company income of the shareholder.

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[378] Sec. 541.
[379] Sec. 542.
[380] Sec. 543.
[381] Secs. 951–965.
[382] A separate set of rules applies to income of a foreign corporation that is a passive foreign investment corporation, generally defined as a foreign corporation 75 percent or more of the gross income of which is passive income, or 50 percent or more of the assets of which produce or are held for the production of passive income (sec. 1297). Such income is either subject to an interest charge for deferral when it is ultimately distributed to a U.S. shareholder, or an election can be made to include income currently even if not distributed (secs. 1291–1298). A corporation is not treated as a passive foreign investment corporation with respect to any U.S. shareholder during the period such corporation is a controlled foreign corporation of which the shareholder is a 10-percent or greater owner under the rules relating to controlled foreign corporations (sec. 1297(d)).
[383] A 10-percent corporate shareholder may be allowed a foreign tax credit for the foreign income taxes paid on the earnings and profits distributed as a dividend (sec. 902). Also, a dividends-received deduction is allowed to a corporate shareholder to the extent the dividend is attributable to certain U.S. source income, and no foreign tax credit is allowed with respect to any such amount. (sec. 245). A dividend received by an individual is a qualified dividend, eligible for the maximum 20-percent tax rates, if the dividend is from a qualified foreign corporation (generally, a corporation (i) that is eligible for certain treaty benefits or is incorporated in a U.S. possession, or (ii) the stock of which with respect to which the dividend is paid readily tradable on a U.S. securities market, and that in either case is not a passive foreign investment company (sec. 1(h)(11)(C)).

The Committee also believes that the personal holding company tax currently deters the repatriation of earnings that would be repatriated if the U.S. corporate tax alone (but not the personal holding company tax) were applicable to the repatriated earnings.

EXPLANATION OF PROVISION

Under the provision, dividends received by a 10-percent U.S. shareholder (as defined in section 951(b)) from a controlled foreign corporation (as defined in section 957(a)) are excluded from the definition of personal holding company income for purposes of the personal holding company tax.

EFFECTIVE DATE

The provision applies to taxable years ending on or after the date of enactment.

6. Inflation adjustment for certain civil penalties under the Internal Revenue Code (sec. 307 of the bill and secs. 6651, 6652(c), 6695, 6698, 6699, 6721, and 6722 of the Code)

PRESENT LAW

The Code provides for both civil and criminal penalties to ensure complete and accurate reporting of tax liability and to discourage fraudulent attempts to defeat or evade tax. Civil and criminal penalties are applied separately. Thus, a taxpayer convicted of a criminal tax offense may be subject to both criminal and civil penalties, and a taxpayer acquitted of a criminal tax offense may nonetheless be subject to civil tax penalties. In cases involving both criminal and civil penalties, the IRS generally does not pursue both simultaneously, but delays pursuit of civil penalties until the criminal proceedings have concluded.

Civil penalties are provided in Chapter 68 of the Code.[384] Civil penalties are categorized into two types: additions to the tax and additional amounts (herein "additions to tax"), and assessable penalties. The additions to tax are generally subject to deficiency proceedings, and some may be waived under certain circumstances, including a showing of reasonable cause under section 6664.[385] Assessable penalties can be assessed without restrictions (such as the opportunity for preassessment judicial review) applicable in deficiency cases.[386] Assessable penalties may also be waived under certain circumstances, including a showing of reasonable cause under section 6724.

Some penalties are calculated by reference to the tax liability, while others are fixed dollar amounts. Penalties with a fixed dollar amount include penalties in the case of (1) failure to file a tax return or to pay tax,[387] (2) failure to file certain information returns, registration statements, and certain other statements,[388] (3) failure to furnish a copy of the tax return to the taxpayer, failure to sign the return, failure to furnish an identifying number, failure to retain a completed copy of the tax return or retain on a list the name

[384] Secs. 6651–6751.
[385] Secs. 6651–6663.
[386] Secs. 6671–6725.
[387] Sec. 6651(a).
[388] Sec. 6652(c).

and taxpayer identification number of the taxpayer for whom the return was prepared, failure to file correct information returns, negotiation of a taxpayer's check by the tax return preparer, and failure to be diligent in determining eligibility for the earned income credit,[389] (4) failure of a partnership to file a return,[390] (5) failure of an S corporation to file a return,[391] (6) failure to file correct information returns,[392] and (7) failure to file correct payee statements.[393]

The penalty provisions generally contain no automatic mechanism to adjust the amount of the penalty for inflation. However, the penalty provisions in sections 6721 and 6722 are adjusted for inflation every five years and provide a rounding rule.

REASONS FOR CHANGE

The Committee believes that indexing these fixed-dollar penalties will encourage compliance with the tax law. By correlating increases in the amounts to increases in other types of dollar amounts in the economy generally, the penalties can continue to serve as a meaningful economic deterrent to non-compliant behavior.

EXPLANATION OF PROVISION

The provision indexes the fixed-dollar civil tax penalties provided in sections 6651, 6652(c), 6695, 6698, 6699, 6721, and 6722 each calendar year. The provision rounds penalty amounts down to the nearest multiple of five dollars if less than $5,000, otherwise the provision rounds penalty amounts down to the nearest multiple of $500. The provision does not modify the present-law rounding rules in sections 6721 and 6722.

EFFECTIVE DATE

The provision is effective for returns required to be filed after December 31, 2014.

III. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of the "Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014" as reported.

[389] Sec. 6695.
[390] Sec. 6698.
[391] Sec. 6699.
[392] Sec. 6721.
[393] Sec. 6722.

ESTIMATED BUDGET EFFECTS OF S. _____,
THE "EXPIRING PROVISIONS IMPROVEMENT REFORM AND EFFICIENCY ('EXPIRE') ACT OF 2014,"
AS REPORTED BY THE SENATE COMMITTEE ON FINANCE

Fiscal Years 2014 - 2024

[Millions of Dollars]

Provision	Effective	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-19	2014-24
I. Provisions Expiring in 2013														
A. Individual Tax Extenders														
1. Health coverage tax credit (sunset 12/31/15) [1]	cmba 12/31/13	-22	-82	-31	---	---	---	---	---	---	---	---	-134	-134
2. Above-the-line deduction of up to $250 for teacher classroom expenses (sunset 12/31/15)	tyba 12/31/13	-11	-246	-173	---	---	---	---	---	---	---	---	-430	-430
3. Discharge of indebtedness on principal residence excluded from gross income of individuals (sunset 12/31/15)	doia 12/31/13	-471	-3,012	-1,929	---	---	---	---	---	---	---	---	-5,413	-5,413
4. Parity for exclusion from income for employer-provided mass transit and parking benefits (sunset 12/31/15) [2]	ma 12/31/13 & tyba 12/31/13	-44	-105	-30	---	---	---	---	---	---	---	---	-180	-180
5. Mortgage insurance premiums treated as qualified residence interest (sunset 12/31/15)	apoaa 12/31/13	-138	-922	-794	---	---	---	---	---	---	---	---	-1,854	-1,854
6. Deduction for State and local general sales taxes (sunset 12/31/15)	tyba 12/31/13	[3]	-3,382	-2,872	-240	---	---	---	---	---	---	---	-6,494	-6,494
7. Contributions of capital gain real property made for conservation purposes (sunset 12/31/15)	cmi tyba 12/31/13	-23	-64	-53	-12	-2	-7	-21	-27	-23	-20	-18	-160	-268
8. Above-the-line deduction for qualified tuition and related expenses (sunset 12/31/15)	tyba 12/31/13	-15	-344	-237	---	---	---	---	---	---	---	---	-596	-596
9. Tax-free distributions from IRAs to certain public charities for individuals age 70-1/2 or older, not to exceed $100,000 per taxpayer per year (sunset 12/31/15)	dmi tyba 12/31/13	-248	-633	-411	-50	-55	-57	-60	-63	-66	-68	-70	-1,453	-1,779
B. Business Tax Extenders														
1. Modification of the research credit (sunset 12/31/15)	apoia 12/31/13 & cdf tyba 12/31/13	-2,376	-4,238	-2,459	-1,220	-1,071	-941	-821	-755	-720	-697	-661	-12,305	-15,959
2. Modification of temporary minimum LIHTC rate for non-Federally subsidized new buildings (9%) and existing buildings (4%) (sunset 12/31/15)	1/1/14	---	-1	-2	-4	-5	-6	-6	-6	-6	-6	-6	-19	-49
3. Military housing allowance exclusion for determining area median gross income (sunset 12/31/15)	ido/a 1/1/14	-1	-4	-5	-5	-5	-5	-5	-5	-5	-5	-4	-25	-49
4. Indian employment tax credit (sunset 12/31/15)	tyba 12/31/13	-21	-51	-39	-11	-1	---	---	---	---	---	---	-124	-124
5. Modification of the new markets tax credit (sunset 12/31/15)	cyba 12/31/13	-2	-5	-27	-90	-171	-221	-252	-279	-289	-268	-235	-514	-1,838
6. Railroad track maintenance credit (sunset 12/31/15)	epoii tyba 12/31/13	-72	-207	-135	[3]	---	---	---	---	---	---	---	-414	-414
7. Mine rescue team training credit (sunset 12/31/15)	tyba 12/31/13	-1	-2	-1	-1	[3]	[3]	[3]	---	---	---	---	-3	-5
8. Employer wage credit for activated military reservists (sunset 12/31/15)	pma 12/31/13	-5	-58	-121	-79	-12	---	---	---	---	---	---	-274	-274

Provision	Effective	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-19	2014-24
9. Modification of work opportunity tax credit (sunset 12/31/15)........	iwbwftea 12/31/13	-449	-1,126	-938	-368	-164	-81	-31	-4	---	---	---	-3,127	-3,162
10. Modification of qualified zone academy bonds (sunset 12/31/15)........	oia 12/31/13 & [4]	[3]	-3	-11	-24	-34	-39	-38	-36	-34	-33	-32	-111	-284
11. Classification of certain race horses as 3-year property (sunset 12/31/15)........	ppisa 12/31/13	-24	-73	-71	-13	26	39	43	38	22	6	---	-117	-9
12. 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (sunset 12/31/15) [5]........	ppisa 12/31/13	-67	-273	-483	-551	-542	-522	-498	-494	-492	-476	-426	-2,438	-4,825
13. 7-year recovery period for motorsports entertainment complexes (sunset 12/31/15) [6]........	ppisa 12/31/13	-3	-12	-18	-15	-10	-7	-6	-5	-1	2	3	-64	-71
14. Accelerated depreciation for business property on an Indian reservation (sunset 12/31/15)........	ppisa 12/31/13	-56	-155	-138	-32	31	65	73	49	17	-4	-8	-285	-158
15. Bonus depreciation:														
a. Additional first-year depreciation for 50% of basis of qualified property (sunset 12/31/15) [7]........	ppisa 12/31/13 ityeasd	-8,126	-73,611	1,958	28,047	18,113	13,159	8,823	4,851	2,353	1,012	568	-20,459	-2,852
b. Election to accelerate AMT credit in lieu of bonus depreciation (sunset 12/31/15)........	ppisa 12/31/13 ityeasd	-121	-265	-171	-34	-2	-3	-3	-2	-1	[3]	[3]	-596	-602
16. Enhanced charitable deduction for contributions of food inventory (sunset 12/31/15)........	cma 12/31/13	-57	-145	-89	---	---	---	---	---	---	---	---	-292	-292
17. Modification of increased expensing limitations and treatment of certain real property as section 179 property (sunset 12/31/15)........	tyba 12/31/13	-7,249	-12,779	-1,355	6,659	4,230	3,070	2,089	1,148	568	270	162	-7,424	-3,186
18. Election to expense mine safety equipment (sunset 12/31/15)........	ppisa 12/31/13	-12	-16	1	8	5	4	4	3	2	[8]	---	-9	---
19. Special expensing rules for certain film and television productions; special expensing for live theatrical productions (sunset 12/31/15)........	generally pca 12/31/13	-37	-387	-64	136	104	59	44	36	30	26	26	-189	-27
20. Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sunset 12/31/15)........	tyba 12/31/13	-36	-110	-76	---	---	---	---	---	---	---	---	-222	-222
21. Modification of tax treatment of certain payments under existing arrangements to controlling exempt organizations (sunset 12/31/15)........	proaa 12/31/13	-14	-18	-4	---	---	---	---	---	---	---	---	-36	-36
22. Treatment of certain dividends of RICs (sunset 12/31/15)........	[9]	-68	-100	-30	---	---	---	---	---	---	---	---	-198	-198
23. Treatment of RICs as "qualified investment entities" under section 897 (FIRPTA) (sunset 12/31/15)........	1/1/14	-31	-47	-15	---	---		---	---	---	---	---	-93	-93
24. Exception under subpart F for active financing income (sunset 12/31/15)........	[10]	-2,033	-5,166	-3,175	---	---	---	---	---	---	---	---	-10,373	-10,373
25. Look-through treatment of payments between related CFCs under foreign personal holding company income rules (sunset 12/31/15)........	[10]	-808	-1,254	-389	---	---	---	---	---	---	---	---	-2,450	-2,450
26. Exclusion of 100 percent of gain on certain small business stock (sunset 12/31/15)........	saa 12/31/13	2	15	18	---	---	-134	-924	-925	---	---	---	-99	-1,948

Provision	Effective	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-19	2014-24
27. Basis adjustment to stock of S corporations making charitable contributions of property (sunset 12/31/15)	cmi tyba 12/31/13	-16	-58	-28	-2	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-104	-104
28. Reduction in S corporation recognition period for built-in gains tax (sunset 12/31/15)	tyba 12/31/13	-15	-138	-59	-6	-5	-3	-2	-1	-1	-1	-1	-226	-232
29. Empowerment zone tax incentives (sunset 12/31/15)	pa 12/31/13	-81	-205	-153	-27	-12	-4	-2	-3	-4	-4	-3	-483	-498
30. Temporary increase in limit on cover over of rum excise tax revenues (from $10.50 to $13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sunset 12/31/15) [1] [11]	abiUSa 12/31/13	-142	-168	-26	---	---	---	---	---	---	---	---	-336	-336
31. American Samoa economic development credit (sunset 12/31/15)	tyba 12/31/13	-10	-15	-5	---	---	---	---	---	---	---	---	-29	-29
C. Energy Tax Extenders														
1. Modification of credit for section 25C nonbusiness energy property (sunset 12/31/15)	ppisa 12/31/13	-198	-807	-643	---	---	---	---	---	---	---	---	-1,648	-1,648
2. Credit for two-wheeled plug-in electric vehicles (sunset 12/31/15)	vaa 12/31/13	[3]	-2	-1	---	---	---	---	---	---	---	---	-2	-2
3. Second generation biofuel producer credit (sunset 12/31/15)	fpa 12/31/13	-15	-28	-12	---	---	---	---	---	---	---	---	-55	-55
4. Incentives for biodiesel and renewable diesel:														
a. Income tax credits for biodiesel fuel, biodiesel used to produce a qualified mixture, and small agri-biodiesel producers (sunset 12/31/15)	saua 12/31/13	-945	-1,276	-344	---	---	---	---	---	---	---	---	-2,565	-2,565
b. Income tax credits for renewable diesel fuel and renewable diesel used to produce a qualified mixture (sunset 12/31/15)	saua 12/31/13	Estimate Included In Item I.C.4.a.												
c. Excise tax credits and outlay payments for biodiesel fuel mixtures (sunset 12/31/15)	saua 12/31/13	Estimate Included In Item I.C.4.a.												
d. Excise tax credits and outlay payments for renewable diesel fuel mixtures (sunset 12/31/15)	saua 12/31/13	Estimate Included In Item I.C.4.a.												
5. Modification of credit for the production of Indian coal (sunset 12/31/15)	cpa 12/31/13	-18	-31	-15	-4	-3	-2	-1	[2]	---	---	---	-75	-76
6. Beginning-of-construction date for renewable power facilities eligible to claim the electricity production credit or investment credit in lieu of the production credit (sunset 12/31/15)	1/1/14	-75	-116	-234	-580	-1,049	-1,485	-1,749	-1,876	-1,992	-2,064	-2,127	-3,540	-13,347
7. Credit for construction of energy-efficient new homes (sunset 12/31/15)	haa 12/31/13	-95	-192	-114	-55	-49	-42	-36	-23	-6	---	---	-547	-612
8. Special allowance for second generation biofuel plant property (sunset 12/31/15)	ppisa 12/31/13	-1	-3	-2	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	-4	-1
9. Modifications of energy efficient commercial buildings deduction (sunset 12/31/15)	ppisa 12/31/13	-107	-175	-58	7	6	6	5	4	3	3	2	-321	-304
10. Special rule for sales or dispositions to implement Federal Energy Regulatory Commission ("FERC") or State electric restructuring policy for qualified electric utilities (sunset 12/31/15)	da 12/31/13	-232	-336	-45	105	105	105	105	105	72	19	---	-300	---

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Provision	Effective	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-19	2014-24
11. Excise tax credits and outlay payments for alternative fuel, and excise tax credits for alternative fuel mixtures (including extensions for liquefied hydrogen) (sunset 12/31/15)	fsoua 12/31/13 & fsoua 9/30/14	-327	-453	-122	---	---	---	---	---	---	---	---	-903	-903
Total of Provisions Expiring in 2013		**-24,916**	**-112,884**	**-16,230**	**31,539**	**19,429**	**12,948**	**6,730**	**1,730**	**-573**	**-2,307**	**-2,830**	**-90,113**	**-87,361**
II. Provisions Expiring in 2014														
A. Energy Tax Extenders														
1. Alternative motor vehicle credit for qualified fuel cell motor vehicles (sunset 12/31/15)	vpa 12/31/14	---	-30	-16	---	---	---	---	---	---	---	---	-47	-47
2. Alternative fuel refueling property ((including extension for hydrogen property) (sunset 12/31/15)	ppisa 12/31/13	-23	-42	-19	-3	-2	-1	[8]	1	1	1	1	-92	-89
B. Extenders Relating to Multiemployer Defined Benefit Pension Plans														
1. Multiemployer defined benefit plans (sunset 12/31/15) [12]	asa 12/31/14 & pyba 12/31/14	*Gain of less than $500,000*												
Total of Provisions Expiring in 2014		**-23**	**-72**	**-35**	**-3**	**-2**	**-1**	**[8]**	**1**	**1**	**1**	**1**	**-139**	**-136**
III. Revenue Provisions														
1. Penalty for failure to meet due diligence requirements for the child tax credit [1]	tyba 12/31/14	---	[8]	5	5	5	5	5	5	5	5	5	19	43
2. 100 percent continuous levy authority on payment to Medicare providers and suppliers	pmsma DOE	---	57	78	80	81	83	84	86	88	90	91	379	818
3. Exclusion from gross income of certain clean coal power grants	pri tyba 12/31/11	-35	-60	-52	-28	8	41	47	34	24	17	8	-126	4
4. Reform of rules related to qualified tax collection contracts [1]	DOE	[8]	50	214	225	235	246	257	269	282	296	310	970	2,384
5. Special compliance personnel program	acarbsa DOE	*No Revenue Effect*												
6. Exclusion of dividends from controlled foreign corporations from the definition of personal holding company income for purposes of the personal holding company rules	tyeo/a DOE	[8]	1	1	1	1	1	2	2	2	2	2	7	15
7. Inflation adjustment for certain civil tax penalties under the Internal Revenue Code	rrtbfa 12/31/14	---	1	2	4	6	9	12	15	18	21	25	23	115
Total of Revenue Provisions		**-35**	**49**	**248**	**287**	**336**	**385**	**407**	**411**	**419**	**431**	**441**	**1,272**	**3,379**
IV. Sense of the Senate Committee on Finance To Express Support for Comprehensive Tax Reform	**DOE**	***No Revenue Effect***												
NET TOTAL		-24,974	-112,907	-16,017	31,824	19,763	13,332	7,137	2,143	-153	-1,875	-2,388	-88,981	-84,118

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is assumed to be July 1, 2014.

[Legend and Footnotes for the Table appear on the following page]

Legend and Footnotes for the Table:

Legend for "Effective" column:

abiUSa = articles brought into the United States after
acarbsa = amounts collected and retained by the Secretary after
apoaa = amounts paid or accrued after
apoia = amounts paid or incurred after
asa = applications submitted after
cdf = credits determined for
cma = contributions made after
cmba = coverage months beginning after
cmi = contributions made in
cpa = coal produced after
cyba = calendar years beginning after
da = dispositions after
dmi = distributions made in

doia = discharge of indebtedness after
epoii = expenses paid or incurred in
fpa = fuel produced after
fsoua = fuel sold or used after
haa = homes acquired after
ido/a = income determinations on or after
ityeasd = in taxable years ending after such date
iwbwftea = individuals who begin work for the employer after
ma = months after
oia = obligations issued after
pa = periods after
pca = productions commencing after

pma = payments made after
pmsma = payments made six months after
ppisa = property placed in service after
pri = payments received in
proaa = payments received or accrued after
pyba = plan years beginning after
rrtbfa = returns required to be filed after
saa = stock acquired after
saua = sales and uses after
tyba = taxable years beginning after
tyeo/a = taxable years ending on or after
vpa = vehicles purchased after

[1] Estimate includes the following outlay effects:	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-19	2014-24
Health coverage tax credit	20	67	18	---	---	---	---	---	---	---	---	106	106
Increase in limit on cover over of rum excise tax revenues to Puerto Rico and the Virgin Islands [11]	142	168	26	---	---	---	---	---	---	---	---	336	336
Penalty for failure to meet due diligence requirements for the child tax credit	---	---	-4	-4	-4	-4	-4	-4	-4	-4	-5	-17	-40
Reform of rules relating to qualified tax collection contracts	[13]	50	214	225	235	246	257	269	282	296	310	970	2,384
[2] Estimate includes the following effects:	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-19	2014-24
General Fund	-30	-70	-20	---	---	---	---	---	---	---	---	-120	-120
OASDI	-15	-35	-10	---	---	---	---	---	---	---	---	-60	-60

[3] Loss of less than $500,000.
[4] Technical correction regarding Internal Revenue Code section 6431 effective as if included in section 310 of American Taxpayer Relief Act of 2012.
[5] Estimate includes interaction with section 179 and bonus depreciation.
[6] Estimate includes interaction with bonus depreciation.
[7] Estimate includes interaction with section 179.
[8] Gain of less than $500,000.
[9] Effective for dividends paid with respect to any taxable year of regulated investment companies beginning after December 31, 2013.
[10] Effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.
[11] Estimate provided by the Congressional Budget Office.
[12] Estimate is preliminary and subject to change.
[13] Increase in outlays of less than $500,000.

B. BUDGET AUTHORITY AND TAX EXPENDITURES

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that no provisions of the bill as reported involve new or increased budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing provisions of the bill involve increased tax expenditures (see revenue table in Part A., above). The revenue-increasing provisions of the bill involve reduced tax expenditures (see revenue table in part A., above).

C. CONSULTATION WITH CONGRESSIONAL BUDGET OFFICE

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on the bill. The letter from the Congressional Budget Office will be provided separately.

IV. VOTES OF THE COMMITTEE

The Modification to the Chairman's Mark was deemed incorporated into the Mark.

Amendment #5, Schumer/Enzi/Roberts/Stabenow/Cantwell #1, as modified: Modification of IRC Section 41—Innovators Job Creation Act—agreed to by voice vote.

Amendment #49, Brown/Stabenow #7: Manufacturing communities tax credit—agreed to by voice vote.

Amendment #87, Toomey #3: Eliminate crony capitalist energy tax credits—defeated by roll call vote, 6 ayes, 18 nays.

Ayes: Hatch, Roberts, Enzi, Burr, Isakson, Toomey.

Nays: Wyden, Rockefeller, Schumer, Stabenow, Cantwell, Nelson (proxy), Menendez (proxy), Carper (proxy), Cardin (proxy), Brown (proxy), Bennet, Casey (proxy), Warner (proxy), Grassley, Crapo (proxy), Cornyn (proxy), Thune, Portman.

Amendment #6, Schumer/Warner #2: Modification of transportation fringe benefit—bike share—agreed to by voice vote.

Amendment #18, Stabenow #9: Extension of the special rule for electronic transmission sales to implement FERC or state electric restructuring—agreed to by voice vote.

Amendment #14, Stabenow #5: Two year extension of empowerment zone tax incentives—agreed to by voice vote.

Amendment #85, Toomey/Hatch/Burr/Cornyn/Crapo/Roberts/Portman/Isakson/Thune/Enzi #1: Save good paying American jobs and encourage life-saving innovation by delaying the medical device tax for two years. Senator Toomey moved to permit the consideration of the amendment notwithstanding the ruling of the Chair. The motion was defeated by a roll call vote, 9 ayes, 13 nays.

Ayes: Hatch, Grassley, Roberts, Enzi, Thune, Burr, Isakson, Portman, Toomey.

Nays: Wyden, Rockefeller, Schumer, Stabenow, Cantwell, Nelson, Menendez, Carper, Cardin, Brown, Bennet, Casey, Warner.

(Unanimous Consent granted to list Crapo as Aye)

Amendment #26, Menendez/Toomey #1: Small business inflation protection Amendment—agreed to by voice vote.

Amendment #43, Brown/Rockefeller/Portman/Casey/Schumer/Stabenow #1: Extension for health coverage for displaced workers—agreed to by voice vote.

Final Passage of the Expiring Provisions Improvement Reform and Efficiency Act of 2014—agreed to by voice vote.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

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

Impact on individuals and businesses, personal privacy and paperwork

The bill includes provisions to extend present-law tax benefits, expand eligibility for other benefits, and creates new tax incentives. The bill also includes provisions providing for the inflation indexing of civil tax penalties, requiring the Secretary to enter into a qualified tax collection contract or contracts with respect to the collection of inactive receivables, permitting a qualified small business to elect to apply some or all of its research credit as does not exceed $250,000 against its employer OASDI liability rather than against its income tax liability, and requiring paid preparers to meet due diligence requirements with respect to the child tax credit similar to the earned income tax credit's requirements.

The bill includes various other provisions that are not expected to impose additional administrative requirements or regulatory burdens on individuals or businesses.

The provisions of the bill do not impact personal privacy.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the tax provisions of the reported bill do not contain Federal private sector mandates or Federal intergovernmental mandates on State, local, or tribal governments within the meaning of Public Law 104–4, the Unfunded Mandates Reform Act of 1995. The costs required to comply with each Federal private sector mandate generally are no greater than the aggregate estimated budget effects of the provision.

C. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation a summary description of the provision is provided along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and Treasury regarding each of the provisions included in the complexity analysis.

1. EXTENSION OF BONUS DEPRECIATION

Summary description of the provision

The bill extends the 50-percent additional first-year depreciation deduction for two years, generally through 2015 (through 2016 for certain longer-lived and transportation property).

The bill provides that solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less which is placed in service after December 31, 2012 and before January 1, 2016 (January 1, 2017, in the case of certain longer-lived and transportation property) is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted.

The bill also extends the election to increase the AMT credit limitation in lieu of bonus depreciation for two years to property placed in service before January 1, 2016 (January 1, 2017, in the case of certain longer-lived property and transportation property). A bonus depreciation amount, maximum amount, and maximum increase amount is computed separately with respect to property to which the extension of additional first-year depreciation applies ("round 4 extension property").[394]

Under the bill, a corporation that has an election in effect with respect to round 3 extension property to claim minimum tax credits in lieu of bonus depreciation is treated as having an election in effect for round 4 extension property, unless the corporation elects otherwise. The bill also allows a corporation that does not have an election in effect with respect to round 3 extension property to elect to claim minimum tax credits in lieu of bonus depreciation for round 4 extension property. A separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to round 4 extension property.[395]

The bill also includes a technical correction with respect to the taxable year for which an election under section 168(k)(4) is made.

Number of affected taxpayers

It is estimated that the provision will affect over ten percent of small business tax returns.

[394] An election with respect to round 4 extension property is binding for all property that is eligible qualified property solely by reason of the extension of the 50-percent additional first-year depreciation deduction.

[395] In computing the maximum amount, the maximum increase amount for round 4 extension property is reduced by bonus depreciation amounts for preceding taxable years only with respect to round 4 extension property.

Discussion

The reporting requirements are unchanged by this provision. Capital assets purchased during the tax year will still need to be reported on Form 4562; however, the current year tax deduction associated with such assets will increase.

2. INCREASED EXPENSING LIMITATIONS AND TREATMENT OF CERTAIN REAL PROPERTY AS SECTION 179 PROPERTY

Summary description of the provision

The bill provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2014 and 2015, is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 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 $2,000,000. The $500,000 and $2,000,000 amounts are indexed for inflation for taxable years beginning after 2013.

In addition, the bill extends, for taxable years beginning in 2014 and 2015, the treatment of off-the-shelf computer software as qualifying property. The bill also extends the treatment of qualified real property as eligible section 179 property for taxable years beginning in 2014 and 2015, including the limitation on carryovers and the maximum amount of $250,000 for each taxable year. For taxable years beginning in 2014 and 2015, the bill continues to permit a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner.

Number of affected taxpayers

It is estimated that the provision will affect over ten percent of small business tax returns.

Discussion

While taxpayers purchasing section 179 property will still be required to complete and file Form 4562, significantly less detail is required to be included on such form. Accordingly, the compliance burden of many taxpayers will be reduced.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC, April 14, 2014.

Mr. THOMAS A. BARTHOLD,
Chief of Staff, Joint Committee on Taxation,
Washington, DC.

DEAR MR. BARTHOLD: I am responding to your letter dated April 8, 2014, in which you requested a complexity analysis related to the Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014.

Enclosed are the combined comments of the Internal Revenue Service and the Treasury Department for inclusion in the complexity analysis in the Senate Committee on Finance report on the Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act. Our analysis covers the two provisions that you preliminarily identified in your letter: extension of bonus depreciation and increased expensing limitations and treatment of certain real property as section 179 property. Please note that for purposes of this complexity analysis, IRS staff assumed timely enactment of this legislation. If legislation is not enacted before the end of the year, there would be complexity for IRS and for taxpayers that is not addressed in this response.

Our comments are based on the description of the provision provided in your letter. This analysis does not include administrative cost estimates for the changes that would be required. Due to the short turnaround time, our comments are provisional and subject to change upon a more complete and in-depth analysis of the provisions.

Sincerely,

JOHN A. KOSKINEN.

Enclosure.

COMPLEXITY ANALYSIS OF THE COMMITTEE REPORT ON EXPIRING PROVISIONS IMPROVEMENT REFORM AND EFFICIENCY (EXPIRE) ACT OF 2014

1. EXTENSION OF BONUS DEPRECIATION

PROVISION

The bill extends the 50-percent additional first-year depreciation deduction for two years, generally through 2015 (through 2016 for certain longer-lived and transportation property).

The bill provides that solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less which is placed in service after December 31, 2012 and before January 1, 2016 (January 1, 2017, in the case of certain longer-lived and transportation property) is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted.

The bill also extends the election to increase the AMT credit limitation in lieu of bonus depreciation for two years to property placed in service before January 1, 2016 (January 1, 2017, in the case of certain longer-lived property and transportation property). A bonus depreciation amount, maximum amount, and maximum increase amount is computed separately with respect to property to which the extension of additional first-year depreciation applies ("round 4 extension property").

Under the bill, a corporation that has an election in effect with respect to round 3 extension property to claim minimum tax credits in lieu of bonus depreciation is treated as having an election in effect for round 4 extension property, unless the corporation elects otherwise. The bill also allows a corporation that does not have an election in effect with respect to round 3 extension property to elect to claim minimum tax credits in lieu of bonus deprecation for round 4 extension property. A separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to round 4 extension property.

The bill also includes a technical correction with respect to the taxable year for which an election under section 168(k)(4) is made.

IRS/TREASURY COMMENTS

- The extension of the time period for property eligible for additional first-year depreciation would have no significant impact on Form 4562 or any other tax forms. The Instructions for Form 4562, Publication 946, and other instructions and publications would be revised to reflect the extension.
- No programming changes would be required by this Provision.

2. Increased Expensing Limitations and Treatment of Certain Real Property

PROVISION

The bill provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2014 and 2015, is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 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 $2,000,000. The $500,000 and $2,000,000 amounts are indexed for inflation for taxable years beginning after 2013.

In addition, the bill extends, for taxable years beginning in 2014 and 2015, the treatment of off-the-shelf computer software as qualifying property. The bill also extends the treatment of qualified real property as eligible section 179 property for taxable years beginning in 2014 and 2015, including the limitation on carryovers and the maximum amount of $250,000 for each taxable year. For taxable years beginning in 2014 and 2015, the bill continues to permit a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner.

IRS/TREASURY COMMENTS

- The extension of the time period for property eligible for additional first-year depreciation would have no significant impact on Form 4562 or any other tax forms. The Instructions for Form 4562, Publication 946, and other instructions and publications would be revised to reflect the extension.
- No programming changes would be required by this provision.

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

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

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