DESCRIPTION OF THE
"ECONOMIC RECOVERY AND ASSISTANCE FOR AMERICAN WORKERS ACT OF 2001"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on November 8, 2001

Prepared by
the Staff of the
JOINT COMMITTEE ON TAXATION

November 6, 2001
JCX-75-01

CONTENTS

Page

INTRODUCTION

This document,[1] provides a description of the "Economic Recovery and Assistance for American Workers Act of 2001," scheduled for a markup on November 8, 2001, by the Senate Committee on Finance. The description of the provisions in this document were generally prepared by the staff of the Joint Committee on Taxation. However, the provisions contained in Parts VI (Health Insurance Coverage for Displaced Workers), VII (Unemployment Insurance), and VIII (Emergency Agriculture Assistance) of the document were prepared by the majority staff of the Senate Committee on Finance.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Economic Recovery and Assistance for American Workers Act of 2001"* (JCX-75-01), November 6, 2001.

I. SUPPLEMENTAL REBATE FOR INDIVIDUAL TAXPAYERS

Present Law

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

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

On their tax returns for 2001, taxpayers will reconcile the amount of the credit with the check they receive in the following manner. They will complete a worksheet calculating the amount of the credit based on their 2001 tax return. They will then subtract from the credit the amount of the check they received. For many taxpayers, these two amounts will be the same. If, however, the result is a positive number (because, for example, the taxpayer paid no tax in 2000 but is paying tax in 2001), the taxpayer may claim that amount as a credit against 2001 tax liability. If, however, the result is negative (because, for example, the taxpayer paid tax in 2000 but owes no tax for 2001), the taxpayer is not required to repay that amount to the Treasury. Otherwise, the checks have no effect on tax returns filed in 2001; the amount is not includible in gross income and it does not otherwise reduce the amount of withholding. In no event may the Department of the Treasury issue checks after December 31, 2001. This is designed to prevent errors by taxpayers who might claim the full amount of the credit on their 2001 tax returns and file those returns early in 2002, at the same time the Treasury check might be mailed to them. Payment of the credit (or the check) is treated, for all purposes of the Code,[2] as a payment of tax. As such, the credit or the check is subject to the refund offset provisions, such as those applicable to past-due child support under section 6402 of the Code.

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

Description of Proposal

The proposal would provide a new supplemental rebate. Individuals who filed income tax returns for 2000[3] (regardless of whether they had any income tax liability, any payroll tax

---

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

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

liability, or showed any amount as wages) would be eligible for this supplemental rebate. The amount of the rebate would be calculated in the following manner: taxpayers would be eligible for the maximum rebate amount for their filing status ($300 single or married filing separately, $500 head of household, $600 joint filers) minus the amount (if any) of any previous rebate check issued. Thus, for example, if a single person received $100 earlier this year as her rate reduction credit, she would receive an additional $200 as a supplemental rebate. Those taxpayers who earlier received the full amount for their filing statuses would receive no supplemental rebates.

Dependents and nonresident aliens would be ineligible for the supplemental rebates (as they were for the previous rebates).[4] The IRS would be required to send notices to affected taxpayers explaining the computation of their supplemental rebate amounts and how the taxpayer should properly complete the rebate reconciliation schedule contained in the tax return forms package.

The proposal would make a technical correction to EGTRA 2001 to provide that the rate reduction credit enacted by that Act would be treated as a nonrefundable personal credit. The correction thus would allow the rate reduction credit prior to determining the amount of the refundable child credit or the amount of the carryovers of other nonrefundable personal credits, such as the adoption credit.

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

Effective Date

The proposal would be effective on the date of enactment. The notice informing U.S. taxpayers of the amount of their supplemental rebates would be required to be issued, to the maximum extent feasible, by December 25, 2001.[5] In order to prevent difficulties that could

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

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

arise in the simultaneous administration of two rebate provisions, the issuance of checks under the previous rebate provision would be required to cease on the date of enactment of the supplemental rebates.

II. TEMPORARY BUSINESS RELIEF PROVISIONS

A. Special Depreciation Allowance for Certain Property

Present Law

Depreciation deductions

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

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

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

Section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation. Under the income forecast method, a property's depreciation deduction for a taxable year is determined by multiplying the cost of the property by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income to be derived from the property during its useful life.

Expensing election

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

Description of Proposal

The proposal would allow an additional first-year depreciation deduction equal to 10 percent of the adjusted basis of certain qualified property that is placed in service before January 1, 2003. The additional depreciation deduction would be allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.[6] The basis of the property and the depreciation allowances in the year of purchase and later years would be appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer would be allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

Property would qualify for the additional first-year depreciation deduction if the property is (1) property to which MACRS applies with a recovery period of 20 years or less, (2) water utility property as defined in section 168(e)(5), (3) qualified leasehold improvement property[7], (4) motion picture films, sound recordings, books, copyrights, and patents eligible for depreciation under section 167(g), or (5) computer software other than computer software covered by section 197. In order to be qualified property, the original use[8] of the property must commence with the taxpayer on or after September 11, 2001.[9] A special rule precludes the

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

[7] Qualified leasehold improvement property would be any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. The improvement must be made under or pursuant to a lease either by the lessee (or sublessee) of that portion of the building, or by the lessor of that portion of the building. That portion of the building is to be occupied exclusively by the lessee (or any sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service.

Qualified leasehold improvement property would 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.

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

[9] A special rule would apply 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

additional first-year depreciation deduction for property that is required to be depreciated under the alternative depreciation system of MACRS.

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

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

The following examples illustrate the operation of the provision.

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

Example 2. -- Assume that on March 1, 2002, a calendar year taxpayer acquires and places in service qualified property that costs $50,000. In addition, assume that the property qualifies for the expensing election under section 179. Under the provision, the taxpayer is first allowed a $35,000 deduction under section 179.[10] The taxpayer then is allowed an additional first-year depreciation deduction of $1,500 based on $15,000 ($50,000 original cost less the section 179 deduction of $35,000) of adjusted basis. Finally, the remaining adjusted basis of $13,500 ($15,000 adjusted basis less $1,500 additional first-year depreciation) is to be recovered in 2002 and subsequent years pursuant to the depreciation rules of present law.

Effective Date

The proposal would apply to property placed in service after September 10, 2001.

---

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.

[10] A subsequent proposal would temporarily increase the amount deductible under section 179 to $35,000.

B. Increase in Section 179 Expensing

Present Law

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

Description of Proposal

The proposal would provide that the maximum dollar amount that may be deducted under section 179 is increased to $35,000 for property placed in service in taxable years beginning after December 31, 2001, and before January 1, 2003. In addition, the proposal would increase the present law $200,000 limit to $325,000. Thus, under the proposal the $35,000 amount would be reduced by the amount by which the cost of qualifying property placed in service exceeds $325,000. As under present law, no general business credit under section 38 would be allowed with respect to any amount for which a deduction is allowed under section 179. For taxable years beginning after December 31, 2002, present law would apply.

Effective Date

The proposal would apply to taxable years beginning after December 31, 2001.

C. Five-Year Carryback of Net Operating Losses

Present Law

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

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

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

Description of Proposal

The proposal would temporarily extend the general NOL carryback period to five years (from two years) for NOLs arising in a taxable year ending after December 31, 2000 and before January 1, 2002. In addition, the five-year carryback period would apply to NOLs from these years that qualify under present law for a three-year carryback period (i.e., NOLs arising from casualty or theft losses of individuals or attributable to certain Presidentially declared disaster areas).

The proposal also would allow an NOL deduction attributable to these taxable years to offset 100 percent of a taxpayer's AMTI in a carryback year.

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

Effective Date

The proposal would be effective for NOLs arising in taxable years ending after December 31, 2000.

III. TAX INCENTIVES FOR NEW YORK CITY AND DISTRESSED AREAS

A. Expansion of Work Opportunity Tax Credit Targeted Categories to Include Certain Employees in New York City

Present Law

In general

The work opportunity tax credit ("WOTC") is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The credit equals 40 percent (25 percent for employment of less than 400 hours) of qualified wages. Generally, qualified wages are wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer.

The maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages).

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

Targeted groups eligible for the credit

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

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

Expiration date

The credit is effective for wages paid or incurred to a qualified individual who begins work for an employer before January 1, 2002. A separate provision of the Chairman's Mark provides a one-year extension of the WOTC through December 31, 2002.

Description of Proposal

The proposal would create a new targeted group for the WOTC. The new targeted group would be individuals employed by businesses located on or south of Canal street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan, New York, New York (the "New York Recovery Zone") or that relocated from the New York Recovery Zone elsewhere within New York City due to the destruction or damage of their workplaces within the New York Recovery Zone. An employer could claim the credit for work performed after September 10, 2001 and before

January 1, 2003 by such qualified individuals. Unlike the other targeted categories, the credit for the new targeted group would be available for wages paid to both new hires and existing employees. For each employer, the number of employees whose wages would be eligible under the new targeted category could not exceed the number of its employees in the New York Recovery Zone on September 11, 2001. For the new category, the maximum credit would be $4,800 (40 percent of $12,000 of qualified wages) per qualified employee in each taxable year.

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

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

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

Effective Date

The proposal would be effective for wages paid or incurred to a qualified individual for work after September 10, 2001 and before January 1, 2003.

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

Present Law

Rules governing issuance of tax-exempt bonds

In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (Code sec. 103). Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called "private activity bonds."[11] The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

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

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

States or local governments may issue tax-exempt "exempt-facility bonds" to finance property for certain private businesses. Business facilities eligible for this financing include transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, local district heating or cooling, and hazardous waste disposal facilities); privately-owned and/or operated low-income rental housing;[12] and certain private facilities for the local furnishing of electricity or gas. A further provision allows tax-exempt financing for "environmental enhancements of hydro-electric generating facilities." Tax-exempt financing also is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers ("qualified small-issue bonds"), local redevelopment activities ("qualified redevelopment bonds"), and eligible empowerment zone and enterprise community businesses.

Tax-exempt private activity bonds also may be issued to finance limited non-business purposes: certain student loans and mortgage loans for owner-occupied housing ("qualified mortgage bonds" and "qualified veterans' mortgage bonds"). Purchasers of houses financed

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

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

with qualified mortgage bonds must be first-time homebuyers satisfying prescribed income limits, the purchase prices of the houses is limited, the amount by which interest rates charged to homebuyers may exceed the interest paid by issuers is restricted, and a recapture provision applies to target the benefit to purchasers having longer-term need for the subsidy provided by the bonds. Qualified veterans' mortgage bonds are not subject to these limitations, but these bonds may only be issued by five States and may only be used to finance mortgage loans to veterans who served on active duty before January 1, 1977.

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

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

<u>Arbitrage restrictions on tax-exempt bonds</u>

The Federal income tax does not apply to the income of States and local governments that is derived from the exercise of an essential governmental function. To prevent these tax-exempt entities from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than needed for the purpose of the borrowing, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds. In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods" before funds are needed for the purpose of the borrowing) or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, profits that are earned during these periods or on such investments must be rebated to the Federal Government. Governmental bonds are subject to less restrictive arbitrage rules that most private activity bonds.

<u>Miscellaneous additional restrictions on tax-exempt bonds</u>

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

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

"Bank carrying cost" exception

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

Description of Proposal

In general

The proposal would authorize issuance during calendar year 2002 of $15 billion of tax-exempt private activity bonds to finance the construction and rehabilitation of commercial[13] and residential rental[14] real property in a newly designated New York Recovery Zone ("Zone") of New York City.[15] Property eligible for financing with these bonds would include buildings and their structural components, fixed tenant improvements,[16] and functionally related and subordinate public utility property (e.g., gas, water, electric and telecommunication lines). All business addresses located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan will be considered to be located within the New York Recovery Zone.

If the government of New York City determined that it was not feasible to use all of the authorized bond proceeds for property located in the Zone, up to $7 billion of bond proceeds could be used for the construction and rehabilitation of commercial real property (including fixed

---

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

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

[15] Current refundings of outstanding bonds issued under the proposal would not count against the $10 billion volume limit to the extent that the principal amount of the refunding bonds did not exceed the outstanding principal amount of the bonds being refunded. The bonds could not be advance refunded.

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

tenant improvements) located outside the Zone and within New York City.[17] Bond-financed property located outside the Zone would have to meet the additional requirements that the project have at least 100,000 square feet of usable office or other commercial space in a single building or multiple adjacent buildings.

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

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

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

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

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

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

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

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

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

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

---

[17] Public utility property and residential property located outside the Zone could not be financed with the bonds.

Coordination with emergency appropriations

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

Effective Date

The proposal would be effective for bonds issued after the date of enactment.

C. Incentive for Reinvestment in New York City

Present Law

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

In the case of damage or destruction to property used in a trade or business, a taxpayer may deduct any loss sustained, to the extent the loss is not compensated by insurance or otherwise.[18]

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

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

Description of Proposal

The proposal would provide taxpayers with an election to not take into account insurance proceeds in determining gain or loss (for regular tax and alternative minimum tax purposes) with respect to eligible property damaged or destroyed in the New York City Recovery Zone as a consequence of the September 11, 2001 terrorist attacks. Insurance proceeds may be disregarded only to the extent the taxpayer purchases (from an unrelated party) qualified replacement property no later than by December 31, 2006. In general, any increase in loss (or reduction in gain) resulting from this proposal would be taken into account in the taxable year that includes September 11, 2001.[19]

---

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

[19] A taxpayer that makes the election under this proposal would not be permitted to elect under sec. 165(i) to treat such losses as occurring in the preceding taxable year.

Eligible property would mean depreciable tangible personal property and qualified leasehold improvement property,[20] substantially all of the use of which (as of September 11, 2001) was in a business establishment of the taxpayer located in the New York City Recovery Zone.[21] Qualified replacement property would mean tangible personal property or qualified leasehold improvement property purchased by the taxpayer on or after September 11, 2001 and placed in service before January 1, 2007. In addition, the original use of such property in New York City must begin with the taxpayer, and substantially all of the use of such property is reasonably expected to be in the taxpayer's business establishment in New York City.[22]

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

If an election under this proposal is made, the basis of the qualified replacement property is reduced by the amount of the insurance proceeds not taken into account by virtue of this proposal. The amount of the proceeds reinvested in qualified replacement property is treated as depreciation for purposes of sections 1245 and 1250.[23] Therefore, all or a portion of any gain on a sale or exchange of any qualified replacement property may be characterized as ordinary income.

If a taxpayer makes an election provided by the proposal, the time for assessment of any deficiency attributable to the election shall not expire prior to the expiration of three years from the date the Secretary of the Treasury is notified by the taxpayer of the replacement of the converted property or of the intention not to replace (in a manner similar to the extension of the statute of limitations under section 1033(a)(2)). A taxpayer electing the provisions of the proposal would be required to attach a statement in the time and manner as the Secretary of the Treasury shall prescribe. The election would be binding for that taxable year and all subsequent taxable years.

---

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

[21] The "New York City Recovery Zone" is defined to include all business addresses located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan, New York, New York.

[22] Recapture rules similar to section 179(d)(10) would apply with respect to property that ceases to be qualified replacement property.

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

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

The following examples illustrate the operation of the proposal.

Example 1.--A calendar-year corporation owned eligible property with an adjusted basis of $1 million that it used in its trade or business and was destroyed in the New York Recovery Zone. The property was fully insured for its fair market value of $1.5 million and the corporation receives insurance proceeds of that amount. In 2006, the corporation purchases qualified replacement property in New York City at a cost of $1.7 million. If the corporation makes the election provided by the proposal, the corporation would be allowed a deduction for the $1 million cost of its converted property. The corporation's basis in the qualified replacement property would be $200,000 ($1.7 million cost less the $1.5 million of disregarded insurance proceeds). On a disposition of the replacement property, the first $1.5 million of gain would be characterized as ordinary income under this proposal.

Example 2.--Same facts as in example 1 except that the cost of the qualified replacement property is $1.3 million. The corporation would be allowed a deduction for $800,000 on its converted property ($1 million basis less $200,000 of non-reinvested insurance proceeds). The corporation's basis in qualified replacement property would be zero ($1.3 million cost less the $1.3 million of disregarded insurance proceeds). On a disposition of the replacement property, the first $1.3 million of gain would be characterized as ordinary income under this proposal.

Example 3.--Same facts as in example 1 except that the cost of the qualified replacement property is $200,000. The corporation would have gain of $300,000 on its converted property ($1.3 million of non-reinvested insurance proceeds less $1 million basis). The corporation's basis in the qualified replacement property is zero ($200,000 cost less the $200,000 of disregarded insurance proceeds). On a disposition of the replacement property, the first $200,000 of gain would be characterized as ordinary income under this proposal.

Effective Date

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

D. Reenact Exceptions for Qualified Mortgage Bond Financed Loans to Victims of Presidentially Declared Disasters

Present Law

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

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

Description of Proposal

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

Effective Date

The proposal applies to bonds issued during calendar year 2002.

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

Present Law

Rules governing issuance of tax-exempt bonds

In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (Code sec. 103). Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called "private activity bonds."[24] The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

Issuance of tax-exempt private activity bonds for housing

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

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

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

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

per resident of the State or $225 million in calendar year 2002. After 2002, the volume limits will be indexed annually for inflation.

Enterprise zone facility bonds

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

These bonds are exempt from the general State private activity bond volume limits but are subject to the applicable per zone limitations. For bonds issued after December 31, 2001 (other than the DC Enterprise Zone), the following aggregate limitations on the face amount of the bonds apply: (1) 60 million if the zone is located in a rural area; (2) $130 million if the bonds are located in an urban area with a population under 100,000; or (3) $230 million if the zone is an urban area with a population of at least 100,0000.[25]

Special rules for Indian tribes

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

Tax credit for certain low-income housing projects

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

In general, project owners receive low-income housing credits only if the State where the property is located allocates credits to them. States receive annual credit authority of $1.50 per resident (calendar year 2001). This authority is scheduled to increase to $1.75 in calendar year

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

2002; the $1.75 amount will be adjusted for inflation annually after 2002. No allocation of State credit authority is required for low-income housing projects that are financed with the proceeds of tax-exempt bonds if the bonds are issued subject to the State private activity bond volume limits.

Description of Proposal

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

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

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

Finally, Indian tribal governments could allocate authority under the $10 million limit to financing for businesses that would qualify as enterprise zone businesses if the Indian reservation were treated as an empowerment zone. Businesses owned by a tribal government would not be precluded from qualifying for these bonds if all requirements were otherwise met.

All property financed with bonds issued pursuant to this $10 million bond authority would have to be located on the reservation of the issuing tribal government. For these purposes, a reservation would include only those Indian lands over which the tribal government exercised general governmental authority.

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

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

Effective Date

The proposal would be effective for bonds issued after the date of enactment.

IV. EXTENSION OF CERTAIN EXPIRING TAX PROVISIONS

A. Alternative Minimum Tax Relief for Individuals

Present Law

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit[26], the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the IRA credit, and the D.C. homebuyer's credit). For taxable years beginning after 2001, these credits (other than the adoption credit, child credit and IRA credit) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, child credit, and IRA credit are allowed to the full extent of the individual's regular tax and alternative minimum tax.

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

The alternative minimum tax is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is an amount equal to (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent of the remaining AMTI. The maximum tax rates on net capital gain used in computing the tentative minimum tax are the same as under the regular tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments. The exemption amounts are: (1) $45,000 ($49,000 in taxable years beginning before 2005) in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 ($35,750 in taxable years beginning before 2005) in the case of other unmarried individuals; (3) $22,500 ($24,500 in taxable years beginning before 2005) in the case of married individuals filing a separate return; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Description of Proposal

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

---

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

Effective Date

The proposal would be effective for taxable years beginning in 2002.

B. Work Opportunity Tax Credit

Present Law

In general

The work opportunity tax credit ("WOTC") is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The credit equals 40 percent (25 percent for employment of 400 hours or less) of qualified wages. Generally, qualified wages are wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer.

The maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages).

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

Targeted groups eligible for the credit

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

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

Expiration date

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

Description of Proposal

The proposal would extend the work opportunity tax credit for one year (through December 31, 2002).

Effective Date

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

C. Welfare-To-Work Tax Credit

Present Law

In general

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

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

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

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

Expiration date

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

Description of Proposal

The proposal would extend the welfare to work credit for one year (through December 31, 2002).

Effective Date

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

D. Section 45 Credit for Production of Electricity from Wind, Closed Loop Biomass, and Poultry Waste

Present Law

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

The credit applies to electricity produced by a wind energy facility placed in service after December 31, 1993, and before January 1, 2002, to electricity produced by a closed-loop biomass facility placed in service after December 31, 1992, and before January 1, 2002, and to a poultry waste facility placed in service after December 31, 1999, and before January 1, 2002. The credit is allowable for production during the 10-year period after a facility is originally placed in service. In order to claim the credit, a taxpayer must own the facility and sell the electricity produced by the facility to an unrelated party. In the case of a poultry waste facility, the taxpayer may claim the credit as a lessee/operator of a facility owned by a governmental unit.

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

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

Description of Proposal

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

Effective Date

The proposal would be effective on the date of enactment.

E. Taxable Income Limit on Percentage Depletion for Marginal Production

Present Law

In general

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

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

Under the percentage depletion method, generally, 15 percent of the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year (sec. 613A(c)). The amount deducted generally may not exceed 100 percent of the net income from that property in any year (the "net-income limitation") (sec. 613(a)). The Taxpayer Relief Act of 1997 suspended the 100-percent-of-net-income limitation for production from marginal wells for taxable years beginning after December 31, 1997, and before January 1, 2000. The suspension of the limitation was extended to include taxable years beginning before January 1, 2002. Additionally, the percentage depletion deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income (determined before such deduction and adjusted for certain loss carrybacks and trust distributions) (sec. 613A(d)(1)).[27] Because percentage depletion, unlike cost depletion, is computed without regard to the taxpayer's basis in the depletable property, cumulative depletion deductions may be greater than the amount expended by the taxpayer to acquire or develop the property.

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

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

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

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

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

Description of Proposal

The proposal would extend the period when the 100-percent net-income limit is suspended to include taxable years beginning after December 31, 2001, and before January 1, 2003.

Effective Date

The proposal would be effective on the date of enactment.

F. Authority to Issue Qualified Zone Academy Bonds

Present Law

Tax-exempt bonds

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. Activities that can be financed with these tax-exempt bonds include the financing of public schools (sec. 103).

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments are given the authority to issue "qualified zone academy bonds" ("QZABs") (sec. 1397E). A total of $400 million of qualified zone academy bonds may be issued annually in calendar years 1998 through 2001. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and AMT liability.

The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond.

"Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

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

Description of Proposal

The proposal would authorize issuance of up to $400 million of qualified zone academy bonds annually in calendar year 2002.

Effective Date

The proposal would be effective on the date of enactment.

G. Exceptions Under Subpart F for Active Financing Income

Present Law

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

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

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

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business (so-called "active financing income").[28]

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

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

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

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

In the case of a life insurance or annuity contract, reserves for such contracts are determined as follows for purposes of these provisions. The reserves equal the greater of: (1) the net surrender value of the contract (as defined in sec. 807(e)(1)(A)), including in the case of pension plan contracts; or (2) the amount determined by applying the tax reserve method that would apply if the qualifying life insurance company were subject to tax under Subchapter L of the Code, with the following modifications. First, there is substituted for the applicable Federal interest rate an interest rate determined for the functional currency of the qualifying insurance company's home country, calculated (except as provided by the Treasury Secretary in order to address insufficient data and similar problems) in the same manner as the mid-term applicable Federal interest rate (within the meaning of sec. 1274(d)). Second, there is substituted for the prevailing State assumed rate the highest assumed interest rate permitted to be used for purposes of determining statement reserves in the foreign country for the contract. Third, in lieu of U.S. mortality and morbidity tables, mortality and morbidity tables are applied that reasonably reflect the current mortality and morbidity risks in the foreign country. Fourth, the Treasury Secretary may provide that the interest rate and mortality and morbidity tables of a qualifying insurance company may be used for one or more of its branches when appropriate. In no event may the reserve for any contract at any time exceed the foreign statement reserve for the contract, reduced by any catastrophe, equalization, or deficiency reserve or any similar reserve.

Present law also provides a temporary exception from foreign personal holding company income for income from investment of assets equal to 10 percent of reserves (determined for purposes of the provision) for contracts regulated in the country in which sold as life insurance or annuity contracts. This exception does not apply to investment income with respect to excess surplus.

Description of Proposal

The proposal would extend for one year the present-law 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, or in the conduct of an insurance business.

Effective Date

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

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

Present Law

A $13.50 per proof gallon[29] excise tax is imposed on distilled spirits produced in, or imported or brought into, the United States. The excise tax does not apply to distilled spirits that are exported from the United States or to distilled spirits that are consumed in U.S. possessions (e.g., Puerto Rico and the Virgin Islands).

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

Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.

Description of Proposal

The proposal would extend the $13.25-per-proof-gallon coverover rate for one additional year, through December 31, 2002.

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

Effective Date

The proposal would be effective on the date of enactment.

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

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

Present Law

Excise taxes are imposed on highway motor fuels, including gasoline, diesel fuel, and kerosene, to finance the Highway Trust Fund programs. Subject to limited exceptions, these taxes are imposed on all such fuels when they are removed from registered pipeline or barge terminal facilities, with any tax-exemptions being accomplished by means of refunds to consumers of the fuel.[30] One such exception allows removal of diesel fuel or kerosene without payment of tax if the fuel is destined for a nontaxable use (e.g., use as heating oil) and is indelibly dyed.

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

Description of Proposal

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

Effective Date

The proposal would be effective on the date of enactment.

---

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

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

Certain costs of qualified clean-fuel vehicle property and clean-fuel vehicle refueling property may be expensed and deducted when such property is placed in service (sec. 179A).[31] Qualified clean-fuel vehicle property includes motor vehicles that use certain clean-burning fuels (natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity and any other fuel at least 85 percent of which is methanol, ethanol, any other alcohol or ether). The maximum amount of the deduction is $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds or a bus with seating capacities of at least 20 adults; $5,000 in the case of a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. Qualified electric vehicles do not qualify for the clean-fuel vehicle deduction.

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

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

<u>Description of Proposal</u>

The proposal would defer the phase down of the deduction for clean-fuel vehicle property by one year. Taxpayers could claim the full amount of the deduction for qualified vehicles placed in service in 2002. The phase down of the deduction for clean-fuel vehicles would commence in 2003 and the deduction would be unavailable for purchases after December 31, 2005. A conforming modification would be made to section 280F.

The proposal would extend the placed in service date for clean-fuel vehicle refueling property by one year. The deduction for clean-fuel vehicle refueling property would be available for property placed in service prior to January 1, 2006.

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

Effective Date

The proposal would be effective on the date of enactment.

K. Credit for Purchase of Electric Vehicles

A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000 (sec. 30). A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current, the original use of which commences with the taxpayer, and that is acquired for the use by the taxpayer and not for resale. The full amount of the credit is available for purchases prior to 2002. The credit phases down in the years 2002 through 2004, and is unavailable for purchases after December 31, 2004.[32]

Description of Proposal

The proposal would defer the phase down of the credit by one year. Taxpayers could claim the full amount of the credit for qualified purchases made in 2002. The phase down of the credit value would commence in 2003 and the credit would be unavailable for purchases after December 31, 2005. A conforming modification would be made to section 280F.

Effective Date

The proposal would be effective on the date of enactment.

---

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

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

Prior Law

The Mental Health Parity Act of 1996 amended ERISA and the Public Health Service Act to provide that group health plans that provide both medical and surgical benefits and mental health benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits. The provisions of the Mental Health Parity Act are effective with respect to plan years beginning on or after January 1, 1998, but do not apply to benefits for services furnished on or after September 30, 2001.

The Taxpayer Relief Act of 1997 added to the Internal Revenue Code the requirements imposed under the Mental Health Parity Act, and imposed an excise tax on group health plans that fail to meet the requirements. The excise tax is equal to $100 per day during the period of noncompliance and is imposed on the employer sponsoring the plan if the plan fails to meet the requirements. The maximum tax that can be imposed during a taxable year cannot exceed the lesser of 10 percent of the employer's group health plan expenses for the prior year or $500,000. No tax is imposed if the Secretary determines that the employer did not know, and exercising reasonable diligence would not have known, that the failure existed.

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

Description of Proposal

The excise tax on failures to comply with mental health parity requirements would be extended for one year.[33]

Effective Date

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

[33] The related provisions of ERISA and the Public Health Service Act, which also expired on September 30, 2001, have not been extended. However, the Senate has amended the 2002 Labor-HHS appropriations bill (H.R. 3061) to apply expanded requirements under ERISA and the Public Health Service Act as of 2003.

M. Combined Employment Tax Reporting

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the Internal Revenue Service ("IRS") to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

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

To implement that demonstration project, the Taxpayer Relief Act of 1997 amended the Code to authorize the IRS to disclose the name, address, taxpayer identifying number, and signature of the taxpayer, which is common to both the State and Federal portions of the combined form. The Code permits the IRS to disclose these common data items to the State and not have it subject to the redisclosure restrictions, safeguards, or criminal penalty provisions.[34] Essentially, the State is allowed to use this information as if the State directly received this information from the taxpayer.

Description of Proposal

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

Effective Date

The proposal would be effective on the date of enactment.

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

V. EXTENSION OF CERTAIN TRADE PROVISIONS EXPIRING IN 2001

A. Generalized System of Preferences

Present Law

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

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

To qualify for the Generalized System of Preferences privileges, each beneficiary country is subject to various mandatory and discretionary eligibility criteria. Title V specifies the criteria for determining the Generalized System of Preferences country and product eligibility and limitations on the extension of the Generalized System of Preferences treatment. Several articles are statutorily exempt from preferential treatment, including certain textile and apparel articles, watches, and many other import-sensitive products. The Generalized System of Preferences program currently provides unilateral, non-reciprocal duty-free treatment to about 6200 articles from approximately 140 beneficiary developing countries and territories to assist their economic development and increase diversification of their economies through preferential market access.

Section 114 of the Africa Growth and Opportunity Act (P.L. 106-200), enacted on May 18, 2000, extended the Generalized System of Preferences benefits through September 30, 2008 for qualified sub-Saharan African countries.

Description of Proposal

The proposal would renew the generalized system of preferences for the period of October 1, 2001, through December 31, 2002. The proposal would also include a retroactive provision which would provide duty-free treatment for items imported after September 30 that would have qualified for coverage if the Generalized System of Preferences had not expired. Imports made after September 30, 2001, and before the date of enactment would be eligible for duty-free treatment and refunds of any duty paid.

Effective Date

The proposal would be effective on October 1, 2001.

B. Andean Trade Preference Initiative

Present Law

The Andean Trade Preference Act provides preferential, mostly duty-free, treatment of selected U.S. imports from Bolivia, Ecuador, Columbia, and Peru. The Act authorizes the President to proclaim duty-free treatment for eligible articles from a beneficiary country, in accordance with the requirements of the Act. The Andean Trade Preference Act was originally introduced in 1991 as part of an initiative to address the growing narcotics trade problem in Latin America by promoting economic development as a way to create viable alternatives to illicit drug production. The Act provides an incentive for redirecting resources used for drug-related activities to Andean Trade Preference Act-eligible products. The Andean Trade Preference Act expires December 4, 2001.

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

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

The Andean Trade Preference Act operates in addition to the Generalized System of Preferences.

Description of Proposal

The proposal would extend the trade benefits available under the Andean Trade Preference Act through December 31, 2002.

Effective Date

The proposal would be effective on December 5, 2001.

C. Trade Adjustment Assistance Program

Present Law

Three trade adjustment assistance programs have been enacted at different times beginning with the Trade Act of 1974. Congress has renewed the programs since then. The current authorization expired on September 30, 2001, and has been extended in a Continuing Resolution through November 15, 2001. The three trade adjustment assistance programs are: (1) trade adjustment assistance for workers, (2) trade adjustment assistance for firms, and (3) the North American Free-Trade Agreement trade adjustment assistance. The programs provide direct assistance and training to workers who are laid off in trade-impacted industries. Approximately 163,000 workers per year use the programs, which cost $457 million annually. The main beneficiaries are apparel/textile, oil and gas, electronics, and the metal/machinery industries.

Section 245 of the Trade Act of 1974, as amended (19 U.S.C. 2317), authorizes appropriations to the Department of Labor for the period beginning October 1, 1999 through September 30, 2001, of such sums as may be necessary to administer the general trade adjustment assistance and North American Free Trade Act-related trade adjustment assistance programs of Chapter 2 of Title II of that Act. Section 250(d)(2) of the Trade Act of 1974 caps the funding for North American Free Trade Act training programs for the period at $30,000,000.

Section 256 of the Trade Act of 1974, as amended (19 U.S.C. 2346(b)), authorizes appropriations to the Department of Commerce for the period beginning October 1, 1999 through September 30, 2001, of such sums as may be necessary to administer the trade adjustment assistance for firms program (Chapter 3 of Title II of the Trade Act of 1974, as amended).

Description of Proposal

The proposal would extend the authorization of the trade adjustment assistance programs through December 31, 2002.

Effective Date

The proposal would be effective on the date of the enactment.

VI. HEALTH INSURANCE COVERAGE FOR DISPLACED WORKERS

A. COBRA Coverage

Present Law

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

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

Description of Proposal

The proposal would provide a temporary 75 percent premium subsidy for displaced workers who are eligible for COBRA coverage. Workers who lose their jobs after September 11, 2001 and are eligible for COBRA would be eligible to receive such subsidies for up to 12 months. All benefits would end no later than December 31, 2002, regardless of how long a worker has received such coverage.

The Secretary of Treasury, in consultation with the Secretary of Labor, would administer the program through appropriate direct payment arrangements with group health plans, employers, and/or state unemployment insurance offices. States can choose to administer this program provided that they notify the Secretary and develop a plan for making the subsidies available by January 1, 2002. States would also be given the flexibility to provide "wrap-around" premium assistance for low-income workers who are COBRA eligible but not able to pay their share of the COBRA premium.

Effective Date

The proposal would expire on December 31, 2002.

B. Medicaid Coverage

Present Law

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

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

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

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

Description of Proposal

The proposal would create a temporary state option to provide Medicaid coverage to workers who were laid off after September 11, 2001, and who are not eligible for COBRA. Such workers include those who worked for small businesses, for firms that go bankrupt or drop health coverage for their remaining employees. All benefits would end by December 31, 2002, regardless of how long a displaced worker has been covered.

States electing this option would receive the enhanced CHIP matching rate and are permitted to use the same eligibility criteria allowed through the Workers Incentive Improvement Act of 2000 (i.e., full subsidies up to 250 percent of poverty and sliding-scale assistance up to 450 percent of poverty). States could also choose to subsidize the remainder of the premium for low-income Americans eligible for the 75 percent COBRA premium subsidy.

Effective Date

The proposal would expire on December 31, 2002.

C. Temporary Increase in Federal Medicaid Matching Rate

Present Law

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

Federal Medicaid matching rates are based on a state's per capita income relative to the national average and are determined by census data from the most recently available three calendar years. Because the Medicaid matching rates for FY 2002 are based on state per capita income data for the years 1997, 1998 and 1999, changes in states' matching rates for 2002 were triggered by changes in their economies that occurred during those years. More recent economic trends are not reflected in the new matching rates. Because the economy was especially strong from 1997-1999, the FY 2002 federal Medicaid matching rates are reduced for 29 states. Rates in three states are reduced by more than two percentage points.

Description of Proposal

The proposal would provide temporary financial assistance to States to help them meet the temporary rise in Medicaid costs that will result from the recent economic downturn. First, States in which the federal Medicaid matching rate is falling in fiscal year 2002 would be "held harmless" and retain their fiscal year 2001 matching rate. States in which the rates are rising would shift to the fiscal year 2002 rate. Second, all States would receive a federal Medicaid matching rate increase of 1.0 percent. Third, States with higher than average unemployment rates over the previous three months would receive an additional 1.0 percent increase – bringing their total matching rate increase to 2.0 percent. In exchange for these increases, States would maintain current eligibility levels.

Effective Date

The proposal would be effective for fiscal year 2002 only.

VII. UNEMPLOYMENT INSURANCE

A. Extended Benefits

Present Law

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

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

Congress has occasionally provided extended benefits on a Federally funded basis. Since 1970, Congress has acted 4 times -- in 1971, 1974, 1982, and 1991 -- to establish temporary programs of supplemental assistance.

Description of Proposal

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

B. Part-Time Workers

Present Law

In general, states set the rules to determine whether an unemployment applicant is "available for work" and willing to "accept suitable employment." Also, a general program rule is that the unemployed look for work "comparable" to their previous employment. Thirty-one states require that someone on unemployment pursue full-time employment as part of being "available for work" and willing to accept "suitable employment." Those working part-time, such as thirty hours a week, have unemployment taxes paid on their behalf and can often meet the other criteria – such as minimum earnings tests – to be eligible for benefits. Many states require them to seek full-time work to receive benefits.

Nationwide, just under 20 percent of workers are employed part-time. For some this is because they are unable to get full-time work – they are usually eligible for benefits because they will work full-time. But others believe they are only able to work part-time. About 300,000 former part-time workers are ineligible for benefits because of the full-time requirement per year.

Description of Proposal

The proposal would make those seeking part-time work eligible for benefits. The benefits would be wholly Federally-funded and available until December 31, 2002. State rules concerning minimum earnings requirements and other eligibility criteria would still apply. Part-time work would be defined as employment comparable to an applicant's previous job or would be permitted for those who showed good cause for their work availability being part-time only. States which already provide these benefits would receive Federal funding for them.

C. Alternative Base Period

Present Law

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

Description of Proposal

For those applicants found ineligible for benefits, the proposal would require states to redetermine eligibility using the most recently completed quarter's data. If an applicant's "alternative base period" wage history would make the applicant eligible then benefits would be provided, according to the normal state formulas. The benefits would be Federally-funded and would be available until December 31, 2002.

D. Supplemental Benefits

Present Law

States determine unemployment benefit levels. Typically, they are set to replace 50 percent of the recipients former wages, up to a maximum. Those with higher earnings as workers generally receive higher benefits. The national weekly average is $231 and average wage replacement is 47 percent. This represents about 2/3 of the poverty line for a family of four.

Description of Proposal

The proposal includes a temporary Federal supplement to UI benefits of 15 percent or $25 per week, whichever is higher. For the average unemployed recipient this would be an additional $35 per week. The supplement would be included in benefits provided under the extended benefit, part-time worker, and "alternative base period" provisions of the proposal as well.

E. Administrative Funding

Present Law

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

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

Description of Proposal

The proposal would provide an additional $500 million accelerated “Reed Act” distribution of funds from the Federal UI accounts to States.

F. Financing

Present Law

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

The Federal unemployment tax, known as FUTA, is 6.2 percent on the first $7,000 of wages, but is reduced to 0.8 percent in States with approved programs. These funds are deposited into three federal unemployment accounts. The first, the Employment Security Administration Account, supports State program administration. The second, the Extended Unemployment Compensation Account, provides the funds for the 50 percent share of the extended benefits program. The third, Federal Unemployment Account, provides funds for loans to State unemployment programs in distress to ensure a continued flow of benefits.

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

Description of Proposal

The proposal would use funds in the Federal accounts to pay for the benefits. Because of the CBO projections of Reed Act distributions, the 10 year costs of the proposal are zero – the proposal is paid for by accelerating spending due to occur over the next ten years.

VIII. EMERGENCY AGRICULTURE ASSISTANCE

A. Crop Disaster Assistance

Present Law

Congress has periodically established temporary programs in order to provide assistance to farmers who suffered crop losses, including specialty crops, due to natural disaster or quality loss. The most recent programs were authorized in the Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001. Both programs expired at the end of fiscal 2001.

Under the Natural Disaster Program, producers were compensated if their losses exceeded 35 percent of historic yields. The payment formulas provided greater benefits to producers who bought insurance on their eligible crops.

Under the Quality Loss program, farmers were eligible for assistance if they suffered at least a 20 percent loss in 2001-year crop quality due to weather-related disasters.

Description of Proposal

The proposal reestablishes both the Natural Disaster Program and Quality Loss programs for fiscal 2002, on terms identical to those contained in the 2001 law.

B. Livestock Disaster Assistance

Present Law

Congress has periodically established a temporary program to assist livestock producers who suffered grazing losses due to natural disasters. The most recent program was enacted as part of the Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001. The program expired at the end of fiscal 2001.

Under the program, the eligibility of an individual producer was based on whether a natural disaster caused the producer in an approved county to suffer a 40 percent or greater loss of grazing for 3 or more consecutive months during calendar year 2001.

Description of Proposal

The proposal reestablishes the Livestock Assistance Program for fiscal 2002, on terms identical to those contained in the 2001 law. It also provides that not more than $12 million of the amounts made available under the program are for the American Indian Livestock Feed Program.

C. Rural Development Loan and Grant Applications

Description of Proposal

The proposal provides $3 billion to clear the backlog of pending rural development loan and grant applications. Pending applications for community facility grants and direct loans, water and waste disposal grants and direct loans, rural water and wastewater technical assistance and training grants, business and industry guaranteed loans, and solid waste management grants will be eligible for funding under this provision. Applications in the preapplication phase are not eligible for funding under this provision. The funds in the account established under this section will be available only after funds appropriated in the annual appropriations act for fiscal year 2002 for these loans, loan guarantees and grants have been exhausted.

D. Commodity Purchases

Present Law

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

The program encourages the Secretary to purchase such commodities in a manner that reflects geographic diversity with particular attention given to production in the Northeast and Mid-Atlantic States.

Description of Proposal

The proposal authorizes the Secretary to use $220 million of funds from the Commodity Credit Corporation to establish a commodity purchase program for fiscal 2002, to purchase agricultural commodities that have experienced low prices during the 2000 or 2001 crops years. Not less than $55 million of the funds shall be used to purchase agricultural commodities that qualify for and are distributed to schools and service institutions under the School Lunch Act.