1 EXECUTIVE COMMITTEE MEETING - ARMED FORCES TAX

2 FAIRNESS ACT OF 2003; THE CARE ACT OF 2003

3 WEDNESDAY, FEBRUARY 5, 2003

4 U.S. Senate,

5 Committee on Finance,

6 Washington, DC.

7 The meeting was convened, pursuant to notice,

8 at 10:08 a.m, in room SD-215, Dirksen Senate

9 Office Building, Hon. Charles E. Grassley

10 (chairman of the committee) presiding.

11 Also present: Senators Lott, Kyl, Thomas,

12 Santorum, Smith, Bunning, Baucus, Breaux,

13 Jeffords, Bingaman, and Lincoln.

14 Also present: Kolan Davis, Staff Director

15 and Chief Counsel; Theodore Totman, Deputy Staff

16 Director; Jeff A. Forbes, Democrat Staff

17 Director; and Carla Martin, Chief Clerk.

18 Also present: Pamela Olson, Assistant

19 Secretary for Tax Policy, Treasury Department;

20 Mary Schmidt, Deputy Chief of Staff, Joint

21 Committee on Taxation; Dean Zerbe, Republican

22 Chief Investigative Counsel; Edgar McClellan, Tax

23 Counsel; and Patrick Heck, Democrat Chief

24 Investigator.

25

ORIGINAL

OPENING STATEMENT OF THE HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

The Chairman. I thank everybody in the audience for your attention and your patience. I am glad my colleagues are here. We have at least seven, so we can go ahead with the amending process. We have to have 11 here to actually take final action on a bill.

I am going to give my statement on both bills at the same time, although we will handle the bills separately.

The first bill would be the Armed Services Tax Fairness Act. Senator Baucus and I have called this session to mark up this legislation, which has carried over from the last Congress. The Armed Services Tax Fairness Act of 2003 is intended to provide equity and fairness for members of the uniformed service and foreign service personnel. Compensation and taxation of our military personnel is particularly timely as possible military action in the Middle East is just one example of the importance.

In fact, the public today will hear remarks from our Secretary of State before the United

1 Nations regarding the status of inspections in
2 Iraq and the Administration's proposed steps.
3 In addition to ongoing inspections and
4 dialogue with Iraq, we face new and unexpected
5 challenges, as you know, from North Korea.
6 None of this is intended to give short
7 shrift to the theats and difficulties we continue
8 to face in our efforts to secure the homeland in
9 the post-9/11 world that we live in.
10 We depend increasingly upon our members of
11 the uniformed services and their Reserve
12 components to defend our borders and to protect
13 our country. We need then to ensure that our
14 military personnel are adequately compensated,
15 provided with incentives to cointinue their
16 service to our country, and receive equal and
17 fair treatment under our tax laws.
18 In sum, those are the objectives of the
19 military tax bill that we consider today.
20 I have a longer statement that, without
21 objection, I will put in the record, and then go
22 immediately to the statement that I have on what
23 we call the Care Act of 2003.
24 (The prepared statement of Senator Grassley
25 appears in the appendix.)

1 The Care Act of 2003 is specifically about
2 tax provisions that will encourage more
3 charitable giving by Americans. I commend the
4 President for his strong leadership in calling
5 Americans back to our gread tradition of
6 neighbors helpin neighbors.
7 In addition, I would thank the good efforts
8 of the bipartisan team of Senator Santorum and
9 Senator Lieberman for their advancement of this
10 legislation.
11 As we review this legislation, it is mostly
12 the same as that considered by the Finance
13 Committee last year. Key provisions: a
14 charitable deduction for those who do not
15 itemize; the rollover of IRAs, which is
16 important to many charities; provisions that
17 support conservation of our land, and
18 provisions that encourage donations of food to
19 food banks.
20 This bill is virtually identical to the
21 bill that I recently introduced with Senator
22 Baucus. There were other co-sponsors.
23 While most of the contents of the bill
24 before us is virtually identical to last year's
25 bill, I would suggest changes that deal with

1 offsets.

2 The Chairman's mark before us deletes the

3 offset in last year's proposal that was an

4 extension of customer users fee. Extension of

5 these fees has proven to be unpopular with

6 members, and most outspoken on this point has

7 been Senator Kyl, of Arizona.

8 These members have rightly voiced concern

9 about the use of an offset that should be more

10 closely tied to Customs reform, especially the

11 security aspects of Custom reform.

12 I would like to take a few minutes then to

13 address the new revenue raiser.

14 Under the current pay-go rules, we are

15 required to offset any revenue reductions with

16 revenue raisers to avoid point of order.

17 I had planned to use both tax shelters and

18 inversions for this mark, but we found that the

19 inversions bill was not needed at this time. We

20 do plan to reintroduce our inversions bill very

21 soon.

22 So let me reiterate. My warning to those

23 companies planning inversions: Do not proceed.

24 Or if you do you do it at your own peril.

25 Tne new revenue raiser is an expanded tax

1 shelter proposal that was first put forth in
2 Senator Baucus' mark last fall for the farm and
3 small business tax relief measure. This
4 proposal is nearly identical to the legislation
5 entitled Tax Shelter Transparency Act that this
6 committee approved last June with one very
7 significant addition.
8 We have added a provision clarifying the
9 economic substance doctrine which is used by
10 courts to combat tax shelters.
11 Last year, there were several court
12 rulings that, in our view, misapplied the
13 doctrine. These rulings now stand as legal
14 precedent that can be used to justify abusive
15 schemes in the future.
16 If a court finds that a tax shelter
17 violates our clarification, the shelter
18 participant would be subject to a strict 40
19 percent penalty of any tax due. Obviously, this
20 is very tough anti-shelter provisions. However,
21 I remain concerned that the definition may be
22 too vague for taxpayers to know whether this
23 doctrine applies to a planned transaction. If
24 we are going to impose a strict 40 percent
25 penalty, taxpayers need to know with certainty

1 whether they could run afoul.

2 Therefore, I have delayed the effective date

3 of the penalty until April 15th, 2004, so

4 Treasury will have time to provide the necessary

5 tax guidance.

6 We have need to revisit this provision,

7 depending on comments that we receive. And we

8 would do that. Moreover, we may need to revisit

9 our entire tax shelter proposal after our own

10 joint committee releases its Enron report next

11 week.

12 So, with those cautionary comments, we

13 intend to press forward. I have had the full

14 cooperation of Senator Baucus on this. We have

15 worked together for a year on it. But I want to

16 be clear that this is a fluid process, and I take

17 this step on clarification of economic substance

18 doctrine with reservations.

19 Now, I will turn to Senator Baucus before we

20 go through the walk-through. Senator Baucus.

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1 OPENING STATEMENT OF THE HON. MAX BAUCUS, A U.S.
2 SENATOR FROM MONTANA
3
4 Senator Baucus. Thank you, Mr. Chairman.
5 First, I commend you for holding today's
6 markup to advance legislation this committee has
7 already approved. They were good measures then;
8 they are good measures now.
9 Both measures, the Armed Forces Tax
10 Fairness Act and the Care Act of 2003, enjoy
11 widespread bipartisan support. This is very
12 little controversy. We should get on with it.
13 They were overwhelmingly approved by the
14 committee last year.
15 As you recall, unfortunately, we were
16 unable to get these bills enacted into law
17 before we adjourned. And I share your hope,
18 Mr. Chairman, that we can be more successful.
19 This committee is easy. It is kind of the
20 vargaries of the Senate and sometimes a little
21 more difficult, but we can hopefully get it
22 passed very quickly.
23 I am particularly pleased that both bills
24 continue to be fully offset, and they will not
25 be adding to the new growing deficit.

1 More importantly, the offsets are important
2 in their own right. They will shut down tax law
3 noncompliance, abusive shelters, and help ensure
4 that everyone is paying their fare share.
5 Let me say a few words about each measure.
6 First, the CARE Act.
7 The tax provisions in the CARE Act will
8 encourage additional giving to the organizations
9 that serve those in need. With a sluggish
10 economy, charitable giving has not kept pace with
11 increasing demand.
12 In my own State of Montana, for example,
13 the Montana Food Bank Network services one and
14 a half million meals, including meals to almost
15 200,000 children. More and more, people are
16 relying on food banks and soup kitchens for
17 their daily nourishment. Demand is outstripping
18 supply. I am glad today's mark includes
19 additional incentives to spur donations of
20 surplus food.
21 There are number of provisions contained in
22 the CARE Act that will help charities help our
23 communities: Books for literacy programs;
24 computers for schools; contributions of open
25 space for conservation.

1 The mark also includes a number of
2 provisions to improve the oversight of tax
3 exempt organizations. The bill will provide for
4 greater sunshine on charitable activities and
5 State officials will have greater access to
6 information allowing them to ensure that
7 contributions are used for their intended
8 purpose.
9 Second, the Armed Forces Tax Fairness Act.
10 The country is preparing potentially for war
11 with Iraq. Our service personnel should not have
12 to fight the tax code when they are serving our
13 country. Under this measure, the American
14 military personnel would get new tax relief.
15 Death benefits paid to military survivors would
16 be fully exempt from the tax. Capital gain
17 rules would be modified for home sales by service
18 members called away to duty. Military Reservists
19 and National Guard personnel would be allowed to
20 deduct their service-related travel expenses.
21 Last year, the Senate voted without
22 dissent to pass this bill, and I hope that we
23 can move quickly to provide relief to those who
24 are prepared to make the ultimate sacrifice to
25 protect us.

1 Mr. Chairman, yesterday, I attended the
2 memorial service for the Columbia astronauts in
3 Houston. It was a wonderful tribute to
4 America's fallen heroes. And upon return, I
5 introduced legislation to provide assistance to
6 the astronauts' families. The relief package
7 would essentially provide the same benefits as
8 families of military personnel who died in the
9 line of duty. And I am hopeful that we can move
10 on this measure this morning.
11 Third, to the offsets. As you mentioned,
12 Mr. Chairman, the military tax relief bill be
13 paid for by a tax on individuals who renounce
14 their U.S. citizenship.
15 Specifically, the bill would provide that
16 ex-patriots pay the tax they owe on the day they
17 relinquish their citizenship. Treasury should
18 be given new tools to make sure that assets do
19 not move with the ex-patriot before the tax has
20 been paid.
21 The CARE Act would also be paid for with
22 tax shelter legislation developed by the
23 committee over the past three years.
24 It is time to put a stop to the unsavory
25 practice of mining the tax code for abusive

1 shelters. For years, the Finance Committee has
2 been committed to helping combat these
3 carefully engineered transactions that have
4 little or no economic substance. They are
5 designed to achieve unwarranted tax benefits
6 rather than business profit. They place honest
7 corporate competitors at a disadvantage.
8 Treasury believes that if a taxpayer feels
9 comfortable entering into a transaction, if a
10 promoter feels comfortable selling a
11 transaction, and an advisor feels comfortable
12 recommending a transaction, they should all feel
13 comfortable in detailing the transaction to the
14 IRS.
15 I agree with the Treasury. This
16 legislation reinforces Treasury's shelter
17 program and will curb abusive shelters.
18 Under the mark, promoters, advisors,
19 taxpayers will be subject--all of them--to
20 stiff penalties for failing to acknowledge these
21 transactions to the IRS.
22 The mark would also elminate abusive
23 tax shelters by denying tax benefits claimed
24 derived from transactions that do not meet a
25 heightened economic substance requirement. Under

1 the mark, taxpayers will have to enter into
2 transactions for legitimate, economic and
3 business reasons and not for tax avoidance.
4 Shelter legislation is an important step.
5 It is a necessary step, but may not be the final
6 word.
7 The Joint Committee on Taxation is nearing
8 completion of its investigation into Enron.
9 Additional steps may be needed. And I am
10 confident that this committee will not hesitate
11 to take further action.
12 As you mentioned, Mr. Chairman, the
13 legislation does not include the inversions bill
14 that you and I pushed for last year. But
15 companies affected by the inversions
16 legislation should, as you mentioned, not breathe
17 too easily. I urge you to bring this before the
18 committee expeditiously.
19 Thank you again, Mr. Chairman, for holding
20 this markup. And I look forward to continuing
21 to work with you and other members of the
22 committee and all others who want to see good
23 measures enacted into law.
24 The Chairman. Thank you very much.
25 I would like to turn to today's committee's

1 business. The first would be to have the
2 chairman's mark as an original bill, entitled
3 The Armed Forces Tax Fairness Act of 2003.
4 Since the Finance Committee has already
5 considered the legislation, as well as the CARE
6 Act, if there is no objection, I would forego
7 having the Finance Committee staff walk through
8 the chairman's mark for both bills.
9 And we do have before us Christie Mistr,
10 the tax counsel for the Finance Committee; Mary
11 Schmidt, the deputy chief of staff for the Joint
12 Tax panel, and the Assistant Secretary for Tax
13 Policy at the Treasury Department. So we have
14 people that can answer questions that you might
15 have.
16 I would like to ask Ms. Schmidt to describe
17 the modifications to the chairman's mark.
18 Ms. Schmidt. Mr. Chairman, there are two
19 modifications to the chairman's mark for the
20 Armed Forces Tax Fairness Act. The first would
21 clarify the provision that is in the underlying
22 bill relating to regarding the tax exempt status
23 of organizations that are designated as
24 terrorist organizations, to make it clear that
25 if an organization was designated prior to the

1 date of enactment of this bill they will lose
2 their tax exempt status as of the date of
3 enactment.
4 The second item in the chairman's
5 modification would extend the same tax benefits
6 provided under the Victims of Terrorism Tax
7 Relief Act of 2001 to astronauts who are killed
8 in the line of duty on or after January 1st of
9 2003.
10 The Chairman. At this point for the
11 committee, are there any questions of the
12 walk-through at this point?
13 (No response)
14 The Chairman. All right.
15 If there are not any questions, then I
16 would move to modify the chairman's mark. And
17 without objection, the chairman's mark is
18 modified.
19 There were three amendments filed. We have
20 included one in the modification. And my
21 understanding is that the other two amendments
22 will not be offered. And I want to express for
23 all of us the appreciation that we have towards
24 those members who have been willing to withhold
25 those amendments. Thus, I assume that there are

1 no amendments.

2 Let me ask if there are any members wishing
3 to speak before I would move that we favorably
4 report the bill, which obviously we are not
5 going to be able to take final action on because
6 we do not have the full members here.

7 Senator Lott or Senator Bunning?

8 Senator Lott. Mr. Chairman, do you
9 anticipate that you would set a specific time
10 that we might have a discussion on this and the
11 other bill before the committee?

12 The Chairman. It is my hope, Senator Lott,
13 that before we get done with the CARE Act, in
14 other words, just momentarily lay aside this
15 military tax provisions, move to the CARE Act,
16 and do the same thing with the CARE Act that we
17 have done thus far, and then we would have 11
18 people here. If we do not, then it would be my
19 suggestion that we would take care of that later
20 on in the day someway, somehow. But I hope that
21 we can get 11 people here.

22 So, Senator Bunning, do you have a comment?

23 Senator Bunning. Mr. Chairman, I just have
24 an opening statement that I would like to have
25 put into the record. I will not comment on it,

1 specifically.

2 The Chairman. All right.

3 (The prepared statement of Senator Bunning

4 appears in the appendix.)

5 The Chairman. Let's say, not only for

6 Senator Bunning but other members that have

7 opening statement, without objection, those

8 opening statements will be accepted.

9 So, we will set this bill aside, and we

10 will go then to the bill on the CARE Act.

11 Ms. Schmidt, would you describe the

12 modifications in the chairman's mark?

13 Ms. Schmidt. Yes, Mr. Chairman.

14 The chairman's modifications to the CARE

15 Act make several changes to the underlying

16 package and then adds three additional

17 provisions.

18 The first modification to the underlying

19 package is that there is a provision in the CARE

20 Act that imposes an annual filing requirement

21 for certain tax exempt organizations that are not

22 required to file an annual return under present

23 law.

24 The sanction for failing to meet that

25 filing requirement for years under the CARE Act

1 is revocation of tax exempt status. The
2 chairman's modification would extend that same
3 sanction to tax exempt organizations that are
4 required to file the annual return under present
5 law. In other words, it would conform the
6 penalty for failure to meet an annual return
7 requirement.
8 The second modification is the same
9 clarification that was in the Armed Forces Tax
10 Fairness Act, that an organization designated as
11 a terrorist organization prior to the date of
12 enactment would lose its tax exempt status as of
13 the date of enactment of the CARE Act.
14 The third modification. There is a
15 provision in the CARE Act that provides a
16 special rule to make it easier for charitable
17 organizations to make payment to members of the
18 military who are killed or injured in the line of
19 duty. This would extend that provision to
20 astronauts who are killed in the line of duty.
21 And, finally, the effective date for the
22 clarification of the economic substance
23 provision in the tax shelter package in the CARE
24 Act would be changed to transactions after
25 February 15th of 2004 in order to make the

1 package revenue neutral.

2 As I mentioned, there were three new items

3 that would be added in the chairman's

4 modification.

5 The first is the deduction. A charitable

6 deduction would be allowed for certain whaling

7 captains recognized by the Alaska Eskimo Whaling

8 Commission.

9 The second new provision would provide a

10 $10 million annual matching grant for

11 not-for-profit organizations that provide low

12 income taxpayer clinics.

13 And the third provision would extend the

14 present law. There is an enhanced deduction for

15 contributions of inventory to private schools

16 and certain other charitable organizations. This

17 would extend that enhanced deduction to donations

18 of inventory to public schools, but it would not

19 apply to donations of computer property which has

20 a special rule under present law.

21 The Chairman. All right. I thank you for

22 your explanation of the modifications.

23 We have been joined at the table by

24 Mr. McClellan and Mr. Zerbe, tax counsels for the

25 Finance Committee.

1 I need to ask the members after the
2 explanation that we just received, are there any
3 questions that you want to ask of any of the
4 counsel? I know that Senator Bunning has
5 something that he wants to discuss.
6 Would the Senator from New Mexico please
7 proceed?
8 Senator Bingaman. Thank you,
9 Mr. Chairman.
10 Let me just ask to be sure that I am
11 correct. On this charitable contribution
12 induced by nonitemized deductions, CRS did a
13 study last year for those of us here on the
14 Finance Committee indicating that their estimate
15 is that for each dollar of revenue lost to the
16 Treasury we get about 18 cents of charitable
17 contributions. Is that right?
18 Ms. Schmidt. The charitable deduction
19 would clearly be utilized by the people who are
20 currently making charitable contributions. In
21 other words, some portion of that would not be
22 new charitable contributions.
23 Senator Bingaman. So, most of the
24 contributions covered by the deduction are
25 already being made. Is that right?

1 Seventy-two percent of them.

2 Ms. Schmidt. I do not know whether the

3 CRS number is consistent with what we have

4 estimated, but, clearly, the deduction would be

5 available to people who are making charitable

6 contributions now.

7 Senator Bingaman. I have a statement that

8 was issued by the Department of Treasury in 1985

9 --President Reagan was in the White House--

10 arguing against this very provisions, saying that

11 the allowance of a charitable contribution

12 deduction for nonitemizers is administratively

13 burdensome for the Internal Revenue Service and

14 complicated for taxpayers. Do any of you have a

15 comment on that? Obviously, Treasury feels

16 differently about it today.

17 Mr. Zerbe. Senator, I would say one thing.

18 --Treasury can speak to it--is that--both, of

19 course, the CRS study you referred to, and there

20 was a recent CBO study that made similar points

21 on the Treasury--one of the things that we did

22 put into the bill that the administration has

23 since embraced as well is a floor, a significant

24 floor of $250.00 for a single, $500.00 for a

25 married couple. And I think from testimony we

1 have heard and from those reports, the view is
2 that that would help alleviate some of the
3 administrative concerns that you have raised,
4 and also do more to ensure that dollars that are
5 lost to revenues, that the ratio in the sense of
6 dollars lost and the charitable contributions
7 gained will be minimized. So we did try to
8 address some of those legitimate and fair
9 concerns that are out there.
10 And we also have a study in this
11 legislation to revisit. This is only a 2-year
12 program, so we will revisit exactly those points
13 that you have raised to see how it is working.
14 Senator Bingaman. On the issue of it
15 being a 2-year program, the bill, as I
16 understand it, contains an offset for the first
17 two years because we are working on the
18 assumption that this will go out of effect at
19 the end of two years. So it is only offset,
20 assuming that assumption is accurate.
21 Mr. Zerbe. Yes, Senator.
22 Senator Bingaman. Could you tell me how
23 much additional deficit we would be adding if,
24 once adopted, we keep this provision in law over
25 the 10-year period?

1 The Chairman. In other words, the policy
2 that would sunset in two years. if it did not
3 sunset this is permanent law. You want to know
4 what that figure is.
5 Senator Bingaham. Right. Because as I
6 understand it, we have tried to write this in
7 order to offset the cost of this for two years.
8 But we are not offsetting the cost of it for the
9 other eight years.
10 Ms. Olson. If I might. Treasury's
11 estimate, which does include in the budget
12 proposal permance for a provision that matches
13 what is in this bill, is a 10-year cost of
14 $12 billion.
15 Senator Bingaham. A 10-year cost of what?
16 Ms. Olson. Twelve billion dollars.
17 Senator Bingaman. Twelve billion?
18 Ms. Olson. Yes, sir.
19 Senator Bingaham. And how does that
20 compare to the two years?
21 Ms. Olson. The first two years are
22 estimates, a small estimate for 2003, because,
23 of course, we are already significantly into
24 2003, of $199 million; for 2004, $1.358 billion.
25 Senator Bingaham. So, the bill that we

1 have got here only offsets less than $2 billion
2 of the $12 billion that Treasury estimates?
3 Ms. Olson. For a permanent provision,
4 correct.
5 Senator Bingaman. For a permanent
6 provision.
7 And Treasury has proposed in their budget
8 that this be a permanent provision?
9 Ms. Olson. Yes, sir.
10 Senator Bingaman. All right.
11 Mr. Chairman, when we get a chance to
12 debate it I will explain my concern and the
13 reason I am not able to support it.
14 And I do have an amendment which I would
15 like to at least discuss when the time is right.
16 The Chairman. Well, that will be present,
17 because we are now going to turn to Senator
18 Bunning.
19 Senator Bunning. Thank you, Mr. Chairman.
20 I have filed an amendment that is aimed at
21 making it easier for nonprofit nursing and
22 elder care facilities to gain access to tax
23 exempt bond markets which might not be otherwise
24 available to them.
25 This amendment was designed in response to

1 the challenges faced by nonprofit agencies that
2 are attemtping to provide these important and
3 much needed elder care facilities, particularly
4 in underserved regions of our country.
5 As you well know, Mr. Chairman, with the
6 aging of our population, the challenges facing
7 the underserved community of the elderly will
8 continue to grow. One way that we can contribute
9 to the good work that these nonprofit nursing
10 homes are doing is by finding ways to help them
11 gain access to affordable capital so that they
12 can continue to serve this important segment of
13 our population.
14 Mr. Chairman, I was prepared to offer this
15 amendment today, but in recognition of the
16 technical nature of this important issue, I would
17 like to forebear consideration at this time with
18 the understanding that our staffs will continue
19 to work together on outstanding issues to
20 prepare for a possible consideration of this
21 issue when we redress these matters on the floor
22 of the Senate.
23 The Chairman. Senator Bunning, I would
24 thank you for bringing this issue to our
25 attention. I know that many of us on this

1 committee have rural areas in our state that
2 constantly struggle for adequate funding for
3 very worthy projects.
4 Senator Baucus and I have had many meetings
5 trying to address the growing need for new
6 nursing homes and assisted living facilities for
7 our underserved rural populations. This is
8 especially true in light of our rapidly aging
9 farm population.
10 My colleague from Kentucky, you know that
11 there have been several technical issues and some
12 overal policy concerns that have arisen in
13 regard to your amendment. But I want to assue
14 you, as you have requested that I do, and that
15 the staff do that we have instructed our staffs
16 accordingly, along with Joint Tax, and,
17 hopefully, the team from Treasury, to continue
18 working on the issue. And, hopefully, even if
19 we would elect temporary relief, we will be able
20 to satisfy the very valid nonprofit community-
21 based elderly care needs addressed in the
22 amendment that you were going to propose. So, I
23 would, once again, thank you, Senator Bunning.
24 Senator Bunning. Thank you, Mr. Chairman.
25 Senator Baucus. Mr. Chairman.

1 The Chairman. Senator Baucus.
2 Senator Baucus. Mr. Chairman, I know that
3 a lot of nonprofit operating nursing homes have
4 faced this problem. They need to face the
5 financing problem. They need some help.
6 There are a good number in Montana,
7 frankly, and they tend to be rural in nature
8 that particularly need financial assistance. And
9 as the Senator said, there is real need. And
10 as the Senator also said, the few details need to
11 be worked out. And I pledge my effort to work
12 with the Senator and with the Chairman to work
13 out a solution.
14 Senator Bunning. I appreciate that. Thank
15 you.
16 The Chairman. Senator Baucus wanted to be
17 recognized for an amendment.
18 Senator Baucus. Mr. Chairman, thank you
19 very much.
20 Mr. Chairman, I call it my amendment
21 number 1 to the Military Act. This is a simple
22 amendment. It requires CEOs to sign federal
23 income tax returns for the corporations.
24 As you know, Mr. Chairman, we held a
25 hearing on corporate covenants a short while ago,

1 and we heard from witnesses who said that this
2 provision would help raise the level of
3 accountability for corporate executives. This
4 has already passed the Finance Committee. It
5 passed last year as part of S. 1971, the
6 National Employees Savings and Trust Equity
7 Guarantee Act. It is also consistent with the
8 Sarbanes-Oxley legislation of 2002.
9 That law requires CEOs and chief financial
10 officers to certify the financial and other
11 information in their company's quarterly and
12 annual reports.
13 Senator Miller pushed the provision that I
14 am talking about on the floor during this
15 Sarbanes-Oxley debate. But because it involves
16 tax returns, I ask that you withdraw this
17 amendment, and with the commitment that we act
18 on this amendment, take it up in the Finance
19 Committee, that is what I am doing today.
20 I might point out that under current law
21 mutual funds are exempt -- under this amendment,
22 mutual funds would be exempt. Mutual fund CEOs
23 thought would have to sign the tax returns for
24 the mutual fund company itself, like Fidelity,
25 but Fidelity, but not for all the separate

1 companies that the major mutual fund handles.
2 It is also important to point out that
3 under current law a signature is required from
4 either the president, the vice president,
5 treasurer, assistant treasuer, chief accounting
6 officer, or any other officer duly authorized
7 has to sign tax returns.
8 My view is that under Sarbanes-Oxley CEOs
9 should certify financials. Certainly the CEO
10 should be responsible for a company's tax
11 return, and not somebody else. And that is just
12 to the amendment. As I said, it exempts mutual
13 funds for obvious reasons. And I hope that you
14 will act favorably on my amendment.
15 The Chairman. I would like to move for
16 consideration of Senator Baucus' amendment.
17 Originally, we were going to set it aside for a
18 minute for Senator Nickles to come down and ask
19 some questions and to discuss it a little bit.
20 I have been informed by his staff that he is not
21 going to come and that we can move forward with
22 it.
23 Is there any further discussion of the
24 Baucus amendment?
25 (No response)

1 The Chairman. If not, those in favor of
2 the Baucus amendment say aye.
3 (A chorus of ayes)
4 The Chairman. Those opposed say no.
5 (No response)
6 The Chairman. The ayes have it. The
7 Baucus amendment is adopted.
8 Senator Bingaman, I believe I should turn to
9 you now because you had a discussion that you
10 wanted to make.
11 Senator Bingaman. Well, Mr. Chairman, I
12 think there are two amendments that I would like
13 to see adopted, either of the two adopted.
14 Senator Thomas has an amendment. It is item
15 number six on this amendment list. And then I
16 had an amendment that would strip out the tax
17 provisions in the bill and go ahead and keep the
18 offsets.
19 I think it is pretty clear in the tax cut
20 provisions and keep the offsets.
21 I think that it is clear the way the bill
22 is now presented to us that at least $10 billion
23 is not offset. I mean, we are writing the bill
24 in such a way that it will expire in two years,
25 but everyone here knows that it will not expire

1 in two years. We will continue it.
2 The Administration has in their budget
3 making it a permanent provision. And I think
4 that it is not responsible for us to be adopting
5 another tax cut bill that just has an additional
6 $10 billion of addition to the deficit, which is
7 what we are doing if we adopt it.
8 Now, whether we get the votes on either of
9 these amendment, I don't know if that makes
10 sense just procedurally. I don't know if
11 Senator Thomas intends to urge his for a vote.
12 The Chairman. Before you offer your
13 amendment, could I ask you to consider
14 something?
15 Senator Bingaman. Yes, sir.
16 The Chairman. I think your point of view
17 on pay-go is legitimate, except for this fact,
18 that we now have a 2-year bill before us. We
19 have offset for the two years. If it sunsets
20 then there is no concrn. And it is going to
21 have to be enacted on by this committee, and
22 assuming the same pay-go rules. Then we would
23 have to have the offset that you are asking for
24 for the third through the tenth year or forever,
25 whatever the case might be. Well, it would be

1 for 10 years because that is what the offset
2 would have to be for even if the statute was
3 permanent
4 So, I was just wondering. As long as this
5 is a 2-year bill, as long as it sunsets, as long
6 as we have paid for it, then it seems to be that
7 it would be more approprite for your amendment
8 to be up at a point where you were extending the
9 bill beyond the two years. And we are not going
10 to do that today.
11 Senator Bingaham. Well, Mr. Chairman, I
12 think in some ways it is a bookkeeping
13 transaction. We are considering a budget from
14 the Administration that has over $300 billion in
15 deficit in it. And I think the responsible
16 thing would be for us to try to be finding ways
17 to offset some of that. And that is why I think
18 it would be more appropriate for us not to
19 enact the additional tax cuts in the bill, but
20 instead to go ahead and adopt the offsets. That
21 would be better fiscal policy, more responsible
22 fiscal policy in my view.
23 I do think that once this provision is in
24 law it will remain in law. And I would be
25 amazed if there is any significant effort to

1 eliminate it. And certainly it would not be a
2 successful effort to eliminate it in the future.
3 So, I would want to at least be recorded against
4 the CARE Act. I voted against it the last time
5 it came up and I would want to be against it.
6 I will withhold offering my amendments
7 since it is clear it would not prevail.
8 The Chairman. I thank the Senator from
9 New Mexico for doing that.
10 I know that Senator Smith has something he
11 wants to bring up. For those of you that are
12 new to the committee thought, before we go to
13 Senator Smith we do have 11 members here, which
14 is the magic number for us to move these two
15 pieces of legislation. That does not preclude
16 further discussion. That does not preclude
17 consideration of amendments as long as we have
18 the 7-member rule.
19 So, could I move on the military bill, that
20 it be brought to a vote? I would move the
21 military bill. Those in favor say aye.
22 (A chorus of ayes)
23 The Chairman. Those opposed say no.
24 (No response)
25 The Chairman. The ayes have it. The

1 Armed Forces Tax Fairness Act legislation is
2 reported out of committee.
3 I would ask that we have the staff have the
4 ordinary permission to make technical
5 corrections. Without objection.
6 I would now move to passage of the CARE
7 Act.
8 Senator Baucus. Mr. Chairman, I so move.
9 The Chairman. All right.
10 Senator Thomas. Mr. Chairman, I do not
11 understand the sequence here.
12 The Chairman. All right. Let me explain
13 again.
14 We have got the magic number of 11 here.
15 Senator Thomas. I understand.
16 The Chairman. There is a lot of people
17 that --
18 Senator Thomas. What about the amendments
19 though?
20 The Chairman. The amendments will be
21 discussed at just the next step we do. I am
22 going to go to Senator Smith for an amendment.
23 Senator Thomas. How many do you need for
24 that?
25 The Chairman. I need seven for that.

1 I thank the ranking member, Senator Baucus.
2 Senator Lincoln. Mr. Chairman, I just
3 want to make a clarification.
4 The Chairman. Yes. The Senator from
5 Arkansas.
6 Senator Lincoln. If we pass an
7 amendment after the bill has passed, you are
8 still going to accept the amendment.
9 The Chairman. Yes.
10 Senator Lincoln. All right.
11 The Chairman. Those in favor of Senator
12 Baucus' amendment say aye.
13 (A chorus of ayes)
14 The Chairman. Those opposed.
15 Senator Bingaman. Senator Baucus'
16 amendment is what?
17 The Chairman. I am sorry. Senator Baucus'
18 motion. I misspoke.
19 Senator Bingaman. His motion to adopt the
20 CARE Act?
21 The Chairman. Yes.
22 Senator Bingaman. No.
23 The Chairman. All right. The ayes appear
24 to have it. The ayes do have it. The CARE Act
25 is reported by the committee. I ask, without

1 objection, that the staff have the authority to
2 make the appropriate technical corrections. And
3 if the Senator from New Mexico wants to be noted
4 in opposition -- do you?
5 Senator Bingaman. Mr. Chairman, could I
6 just ask staff one additional question here?
7 The Chairman. That is appropriate. Then
8 we will go to Senator Smith. I do not want to
9 pass up Senator Lincoln, but I will try to go
10 back and forth. The Senator from New Mexico.
11 Senator Bingaman. The estimated revenue
12 effects that I have been given here show that
13 in 2003, 2004, and 2005, over the next three
14 years, we will in fact not offset this bill. Is
15 that correct?
16 Ms. Schmidt. That is correct. Overall
17 the bill will lose revenue in those three fiscal
18 years.
19 Senator Bingaman. It loses revenue in
20 each of those years?
21 Ms. Schmidt. Yes.
22 Senator Bingaman. And that is assuming
23 that we allow the main provision, the most
24 expensive provision, to sunset after two years.
25 We still lose money.

1 Ms. Schmidt. Yes. The effects of that
2 provision show up in fiscal year 2005 as well.
3 Senator Bingaman. All right. Thank you,
4 Mr. Chairman.
5 Senator Lincoln. Mr. Chairman, could I
6 just ask a question of Joint Tax?
7 The Chairman. The Senator from Arkansas.
8 Senator Lincoln. Thank you, Mr. Chairman.
9 The Joint Tax staff, I did not get a score
10 on my amendment. Could you possibly provide me
11 with that?
12 Ms. Schmidt. Which one, Senator?
13 Senator Lincoln. Two or three.
14 Ms. Schmidt. All right. We scored that
15 amendment as minus $60 million over five years
16 and minus $129 million for the 2003 to 2013
17 period.
18 Senator Lincoln. I am sorry. The $60
19 million was for?
20 Ms. Schmidt. That is 2003 to 2008, and
21 minus $129 million for 2003 to 2013.
22 Senator Lincoln. So, is there a
23 difference?
24 Ms. Schmidt. It is the five and 10 year.
25 Senator Lincoln. All right. But there

1 was not any difference between those two
2 amendments.
3 Ms. Schmidt. No.
4 Senator Lincoln. All right. Thank you.
5 The Chairman. Is the Senator from
6 Arkansas satisfied?
7 Senator Lincoln. Yes, I am, Mr. Chairman.
8 The Chairman. All right.
9 Now, I have amendments, or discussions of
10 amendments, from Senator Smith, Senator Thomas,
11 and Senator Breaux. Is that accurate? I will
12 go to Senator Smith.
13 Senator Smith. Thank you, Mr. Chairman.
14 I have filed an amendment that would allow
15 nonprofit organizations to issue tax exempt bonds
16 to finance the purchase of forested lands; that
17 the lands can be managed for conservation
18 purposes with a limited amount of harvest. This
19 amendment is identical to the provision that
20 Senator Baucus included in the chairman's mark
21 for consideration of the CARE package in this
22 committee just last year.
23 In consultation with your staff, I have
24 agreed to enter into a colloquy with you, sir, on
25 this issue and withdraw the amendment based on

1 a committment by the Finance Committee staff to
2 work towards a resolution during floor
3 consideration.
4 I thank the chairman for his consideration
5 of this important issue and his willingness for
6 his staff to work with me and my staff to a just
7 conclusion.
8 The Chairman. Thank you, Senator Smith,
9 for your work on a very important public policy
10 issue. Your bill will help resolve
11 environmental issues that this nation is faced.
12 And you and your colleagues that are helping you
13 are to be commended for this effort.
14 My staff and I have worked hard to craft
15 this bill in a manner that achieves your
16 important public policy goals while also
17 protecting the integrity of the Internal Revenue
18 Code.
19 While there are some final issues that we
20 need to resolve based on the changes that you
21 proposed, I promise to work with you so that we
22 can have your bill be a part of an amendment
23 package before we bring this bill to the final
24 passage in the Senate.
25 I believe that we can protect the integrity

1 of the tax code while also providing nonprofit
2 forestry organizations with the tools necessary
3 to protect both jobs and environment.
4 Senator Smith. Thank you, Mr. Chairman.
5 The Chairman. Senator Baucus.
6 Senator Baucus. Mr. Chairman, Senator
7 Murray, from Washington, has spoken to me many
8 times about this amendment. It is very similar
9 to the one offered by the Senator from Oregon.
10 And I am joining with you to find a way to work
11 this out because it is a very worthwhile goal and
12 one, frankly, that I personally support. I thank
13 you.
14 The Chairman. All right.
15 Thank you, Senator Smith. Now, Senator
16 Thomas.
17 Senator Thomas. Thank you, Mr. Chairman.
18 I just wanted to express some feelings here.
19 I do have some concerns about this bill as I do
20 on others. It seems to me that we ought to be
21 looking a little more towards tax simplification
22 instead of dealing with tax changes every time we
23 want to change behavior. And so that is an
24 ongoing concern with me.
25 In this case, we are taking people who do not

1 itemize. And we are saying, well, you can
2 itemize, but you still will not be itemizing.
3 And it does not seem like that is a reasonable
4 thing to do.
5 And I am also concerned about the revenue
6 production. Those who have studied it in the
7 past show that the contributions did not change
8 back in the 1980s when this law changed. So, we
9 will see.
10 Because there is a 2-year study there, I am
11 going to withdraw my amendment. But I do hope
12 that we take a long look at this and have a look
13 at it. And keep in mind, every time we want a
14 little something to happen we go in and then we
15 talk about simplifying the Code. We are not
16 doing what we say we always want to do.
17 So, I do support the concept of this bill,
18 and that is to get more and more activities that
19 are related in the private sector. I think that
20 is a great concept. And, therefore, I am going
21 to support the bill.
22 But I do have concerns and I wanted to
23 express those. And I withdraw my amendment.
24 The Chairman. I thank the Senator from
25 Wyoming for his statement and his concern, but

1 also I thank him very much for not bringing forth
2 his amendment.
3 The Senator from Louisiana, Senator Breaux.
4 Senator Breaux. Thank you, Mr. Chairman.
5 I have an amendment dealing with the tax
6 court modernization, which I would ask unanimous
7 consent that Senator Hatch be added as a
8 co-sponsor to our amendment.
9 Mr. Chairman and members, as I think we all
10 know that this committee has jurisdiction over
11 the tax court. The Judiciary Committee has
12 jurisdiction over Article 3 courts, and the
13 district courts and other Federal courts, but
14 uniquely the Finance Committee has jurisdiction
15 over the tax courts, which were created back in
16 the 1960s.
17 The problem is that their procedures have
18 not been updated or modernized since 1969, and
19 they have fallen way behind in their ability to
20 keep up with other courts.
21 The tax court, as we know, basically is the
22 primary place that small businesses go to to
23 resolve tax disputes.
24 We have worked on this legislation--Senator
25 Hatch and I and others--for two years. It has

1 been scrubbed by our staff. It has been looked
2 at and approved by the Joint Committee on
3 Taxation. The Judiciary Committee is an
4 example. The Ways and Means Committee, the
5 Administration and Treasury I think have looked
6 at what we have proposed, and no one has really
7 found any problems of anything that we are
8 talking about doing. And I am trying to find a
9 place to get it enacted, because I think it is
10 good public policy.
11 We do not address a court that is under our
12 jurisdiction. It is going to continue to fall
13 behind and not be able to really serve the
14 public that it is destined to serve.
15 So our amendments, Senator Hatch and mine,
16 is an effort to modernize and update the U.S.
17 Tax Court. And I am offering it here because I
18 have not been able to find any other place to
19 offer it.
20 The Chairman. Well, you would not have had
21 another place so far this year. This is our
22 first bills out of committee.
23 Senator Breaux. I should have added this
24 year or the last Congress. I have not found a
25 place to offer it.

1 The Chairman. All right. Thank you.
2 First of all, I want to convince the Senator
3 from Louisiana that I am in tune with you,
4 except for the fact on this bill. But let me see
5 if I could offer a couple of things to you.
6 Number one, first of all, I had an
7 opportunity to meet with chief judge Wells of
8 the Tax Court, and I told him during that meeting
9 --it was part of the program that he presented to
10 me for consideration--that I planned to include
11 his benefit reform package with a pension bill
12 that Senator Baucus and I work on out of this
13 committee, in fact, pretty much along the same
14 lines as the bill that Senator Baucus and I
15 worked on last year. And so that was I thought
16 the appropriate place to put a pension provision
17 like that.
18 Another alternative I could offer you would
19 be that we could do this entire package of
20 benefit reforms and some administrative
21 procedures that go with it, or Administration
22 measures that could easily go with it as a
23 single bill and as a stand alone bill.
24 Quite frankly, I think if you could accept
25 my good faith promise to do one or the other,

1 although I guess I would prefer to do it in the
2 pension bill, that maybe you would not offer the
3 amendment today.
4 Senator Baucus. Mr. Chairman.
5 The Chairman. Yes.
6 Senator Baucus. Mr. Chairman, I think that
7 is a good suggestion. I too met with Judge
8 Wells. He makes a very good case. And,
9 clearly, as the Senator from Louisiana says, we
10 need to make these changes. There is no doubt
11 about it. The question is where?
12 And because the need is so great, I pledge
13 also and agree with the Senator to do whatever
14 is necessary to find the appropriate time and
15 vehicle to get these measures passed, because
16 they are needed. There is no doubt about it.
17 The Chairman. Thank you.
18 The Senator from Louisiana, Senator Breaux.
19 Senator Breaux. With that enthusiastic
20 endorsement I see the wisdom of your suggestions.
21 And I think we have a comprehensive package here.
22 And if we could have a hearing on it--it would
23 not take long. I would offer to chair it if that
24 helps--but to have a hearing, and just have some
25 testimony on it, and then take it as a package

1 perhaps either as a stand alone bill or add it
2 to something. If we can get an agreement to do
3 that I will not push it at this time.
4 The Chairman. It is even possible that at
5 the same time we have, if you want it to be a
6 separate bill--and I suppose you could do it two
7 ways, as part of the pension bill or as a
8 separate bill--but we could mark it up the same
9 day that we mark up the pension bill.
10 Senator Breaux. That will be fine. That
11 would be very agreeable. Maybe you can do it as
12 an amendment to the pension bill.
13 The Chairman. All right.
14 Senator Breaux. I would withdraw my
15 amendment.
16 The Chairman. All right.
17 I believe that is all of the amendments
18 that have been offered. Does the Senator from
19 Arkansas want to ask a question or speak?
20 Senator Lincoln. Yes, Mr. Chairman. I had
21 an amendment that I would like to offer. It was
22 the increasing to a 10-year divestiture for the
23 business holdings of foundations. And as we
24 mentioned last year when we took this bill up, we
25 talked at great length of the importance of this

1 bill and what it allowed us to do and what it
2 allows foundations to do. Individuals to be
3 able to increase their contributions to
4 foundations and groups. There has been a
5 tremendous amount to areas like where I come
6 from, which is the Mississippi Delta. We have
7 talked about welfare reform. We discussed it.
8 We marked it up. We have done a great job. But,
9 frankly, government cannot do it all.
10 Most of the welfare reform that we have
11 seen in terms of success in the Mississippi
12 Delta region has come because foundations were
13 willing to get in there to make a difference and
14 implement the necessary support mechanisms to
15 make welfare reform a success.
16 And without giving them the ability to do
17 that, to reinvest in areas like the Delta and
18 other impoverished areas of our country, it seems
19 as if we are not going to have really the
20 ability in this bill to do all of the good that
21 we want to see happen.
22 So, I have been encouraged in this last
23 year's debate. I was encouraged last year to
24 work with Treasury, and we have done that. We
25 have worked for a full 12 months on this issue;

1 talked about how we can improve upon it. And we
2 have tried to do just that.
3 We have worked with Treasury to come up with
4 some compromises and I think some good middle
5 ground. And I would like to offer my
6 amendment, and find out what the comments of the
7 chairman might be and certainly what the comments
8 of the Treasury would be.
9 The Chairman. Well, obviously, I can
10 answer for myself. Well, maybe I ought to let
11 Ms. Olson speak first.
12 Ms. Olson. Thank you, Mr. Chairman.
13 We continue to have concerns about Senator
14 Lincoln's amendment. We believe that under
15 current law you can take an additional five
16 years to dispose of excess holdings. But there
17 is a requirement that you show a plan for
18 divestiture the 10-year period. And without
19 such a plan which would be waived by this
20 amendment, there is no assurance that the sales
21 of excess holdings would occur in accordance with
22 the plan over the entire 10 years. In fact, the
23 stock could be held until effectively sometime
24 in the tenth year.
25 And so, we would like to see this modified

1 to that it does come closer to the current law
2 requirement for having a plan for disposition
3 within 10 years, and in a situation where
4 divesting in a shorter period of time would
5 cause a hardship or a loss for the entity.
6 Senator Lott. Mr. Chairman.
7 The Chairman. Senator Lott.
8 Senator Lott. I would like to be heard on
9 this amendment. We talked about it last year. I
10 believe it was included in a bill on the floor of
11 the Senate.
12 Ms. Olson. It never got there.
13 Senator Lott. Well, there was a lot of
14 work back and forth on it. And I know that the
15 Senator from Arkansas has worked with the
16 Treasury Department and continues to do that.
17 It seems to me like a year is enough time to
18 have talked it through and made modifications to
19 it.
20 And I hope this bill succeeds. And it may
21 be wonderfully successful.
22 I think a lot of these things are going to
23 be on the margin in terms of impact. This is one
24 that really would have an impact. It would
25 really make a difference in the poorest of the

1 poor region of the country.

2 The Delta of Arkansas, Mississippi and
3 Louisiana have some of the poorest, most
4 disadvantaged people in this country. You have
5 here an opportunity for a corporate foundation
6 that has been involved, has been a responsible
7 citizen, and is really tryin f to help
8 disadvantaged people with their needs with
9 charitable assistance and in education. And I
10 know we want to move this bill, and I know the
11 committee is trying to work with the Senator from
12 Arkansas, but I will tell you, if we do not do
13 this I really would begin to question what are
14 we doing here?

15 And so I support the Senator from Arkansas.
16 I do not think this is an unreasonable request.
17 If there are some additional modifications that
18 could be made, fine. I am looking at some of
19 them here, and I do not see why we could not do
20 them. If all that we need is a promise to have
21 a plan, great. Let us have a plan. And that is
22 fine. But this is one instance where you really
23 could help make a difference and help people that
24 need it desparately.

25 And so while I have tried to be restrained

1 and follow the leadership of the committee, I
2 cannot for the life of me understand why we
3 cannot work this one out.
4 Senator Lincoln. I thank the Senator from
5 Mississippi, Mr. Chairman, for his work. And I
6 would just encourage the rest of the committee
7 that as we tinker around the edges on some of
8 these initiatives, truly, as we have seen the
9 involvement of many, many foundations in not only
10 being able to help particular area of the
11 Nation but, more importantly, make many of the
12 legislative initiatives that we have started
13 that much more effective when they partner with
14 government and they partner with the initiatives
15 that we have.
16 Mr. Chairman, I would like to ask
17 Treasury if they would be willing to accept this
18 amendment if a reasonable plan is followed in
19 accordance with what Treasury's regulations are.
20 The Chairman. Ms. Olson.
21 Ms. Olson. Yes, Senator, we would be
22 definitely willing to work the Senator on that
23 concept. We also think that the use of the
24 10-year period shoould be triggered by the
25 amount that has to be disposed of by the

1 foundation rather than the amount of the gift.
2 Senator Lincoln. The 2 percent?
3 Ms. Olson. The disposition.
4 Senator Lincoln. All right.
5 Senator Baucus. Mr. Chairman.
6 The Chairman. The Senator from Montana.
7 Senator Baucus. Mr. Chairman, I have
8 sympathy with the Senator from Arkansas with
9 the intent and purpose of what you are trying
10 to accomplish here in accordance with the
11 statement to the State of Mississippi. However,
12 there is a good public policy provision behind
13 current law that has prevented foundations from
14 having excessive holdings of certain stock. And
15 the public policy rationale I have heard thus
16 far for this is to help foundations to keep
17 their holdings longer. And so larger companies
18 could make contributions in effect tax free to
19 a foundation over a 10-year period.
20 I just think there is a lot more to be
21 looked at here. It is a bit expensive, too, I
22 might add, this amendment.
23 But I asked Treasury to redouble its
24 efforts to try to find away to get this passed,
25 because I do think it is a good purpose here.

1 But there are significant questions that are
2 still unresolved in my view.
3 Senator Lincoln. Mr. Chairman, may I
4 just answer to that a little bit?
5 The Chairman. Yes.
6 Senator Lincoln. I certainly understand
7 Senator Baucus' concerns, but I think that the
8 excessive holdings, we still are making sure
9 that the divestiture occurs. We are just
10 giving them a longer period of time to do that.
11 We did reverse what we originally set out
12 to do, which was to increase the percentage that
13 foundations could hold to the time period, which
14 is what Treasury suggested. We felt like that
15 that could help us to achieve the same goal.
16 And I think that a longer time period has
17 been essential in the sense that we see what has
18 happened in the stock market recently.
19 When foundations get a large contribution of
20 stock options it is important for them to have
21 the time to be able to divest themselves in a
22 way that it can fully benefit the foundation.
23 If they are limited in a greater restraint
24 of time, it is going to cause more difficulty in
25 their being able to maximize the gift that has

1 been given to the foundation. So, I think that
2 increasing that amount of time works to the
3 benefit of what we really are trying to achieve
4 here, and that is to assure that the foundations
5 have the resources that they need to be able to
6 do the productive work that we have seen happen.
7 I would ask Joint Task, if I may,
8 Mr. Chairman, if the reasonable plan requirement
9 that we include in that, would that change our
10 score, do you think?
11 Ms. Olson. I don't think so, Senator.
12 The Chairman. Well, let me see if I can
13 satisfy the Senator from Arkansas.
14 First of all, you have worked hard on
15 various aspects of this bill already, so I see
16 your effort as continuing to do the good work
17 you have. You have contributed a lot to this
18 part of the bill about the food donations, the
19 food banks. You have had a lot to do with the
20 part of the bill that dealt with the enhanced
21 contributions for charitable schools. So, you
22 have worked hard.
23 It deserves my consideration a great deal.
24 I think I would like to continue working
25 with you on the legislation. And I would put it

1 kind of in these parameters and invite your
2 reaction along the lines of somewhat what the
3 Treasury has already spoken, some sort of
4 middle ground, somewhere, maybe an amendment
5 that would fall within the neighborhood of 30
6 to 4 million dollars over a 10-year period of
7 time. I think that this would be a level that
8 would help ensure that we keep a balance that
9 charitable interest have at stake.
10 And I would also ask, as they have already
11 promised, that Treasury continue to work with
12 you.
13 Senator Lincoln. Well, Mr. Chairman, in
14 all due respect, we have spent a long time
15 working. We have come, I think, to a real good
16 middle ground. Treasury has been willing to work
17 with us throughout the year. The fact that, I
18 think, today they are willing to accept what we
19 have done with the amendment and the common
20 ground we have come to, if we look for a
21 reasonable plan in accordance with their
22 defined or the definition of Treasury
23 regulations.
24 I just think we are there, Mr. Chairman.
25 And I would certainly hope that the committee

1 would look at all of the work and certainly the
2 compromise that we have put into this
3 initiative, and certainly the whole incentive
4 and initiative that we are trying to move
5 forward in this committee, which is to allow
6 charitable groups to be more of an active
7 player in rounding out what we want to see
8 happen in this country.
9 The Chairman. I think what I was trying
10 to hope is that between now and floor action
11 some of the loose ends that need to be brought
12 in we would be able to do that between now and
13 then.
14 You were very aggressive, legitimately so,
15 at the tail end of the last Congress in pushing
16 your point. I think that the Senator from
17 Mississippi has stated how far that has
18 advanced. And we are just trying to get the
19 last few things brought togethe. And I think
20 that you will find us looking favorable at it.
21 Senator Baucus. Mr. Chairman.
22 The Chairman. Yes.
23 Senator Baucus. Mr. Chairman, I
24 understand the Senator's concerns deeply. We
25 have come a long way but we have not come far

1 enough in this Senator's view to support the
2 amendment. And I think we have had a very good
3 discussion here. And I urge us to find a way to
4 define a solution here and I urge Treasury to
5 work with us in this regard.
6 Senator Lincoln. I am certainly pleased
7 with the comments I have gotten from Treasury
8 today. And again, I think we have all come to
9 the middle ground in working this out. I do not
10 know what more we need to tie up in the sense
11 that if we are going to have a reasonable
12 planning place, which is the biggest concern that
13 Treasury has expressed. We have already
14 changed the whole emphasis of moving from a
15 percentage to a year to accommodate the ability
16 to divest these holdings in a way that is going
17 to be comparable and beneficial in lieu of the
18 marketplace.
19 So, if you are asking me to hold off a
20 vote and wait until we go to the floor, I would
21 rather have a vote and see if we cannot
22 understand certainly from my point of view. And
23 I have been willing to work for the last year to
24 come up with any of the problems that you may
25 have or crop any of the loose ends.

1 Senator Baucus. Mr. Chairman, I
2 understand the Senator, and I have the highest
3 regard for the Senator's judgment on issue like
4 this, but it is my judgment that the Senator
5 would have a better chance to have the
6 amendment passed if she would withdraw the
7 amendment. And I pledge that I will work hard
8 with the Senator to try to figure out a way to
9 make this work.
10 Senator Lincoln. Mr. Chairman, do you
11 have any comments here?
12 (Laughter)
13 The Chairman. I thought I said exactly
14 what he said five minutes ago.
15 (Laughter)
16 The Chairman. Senator Santorum-
17 Senator Santorum. I would just say that
18 I too want to compliment Senator Lincoln for
19 this effort. I know that she has been working
20 on this for quite some time. We thought we
21 had an agreement last year on this that was
22 similar in nature to what the Senator is
23 proposing.
24 Senator Lincoln. We did.
25 Senator Santorum. While I have not worked

1 on the issue like Senator Lincoln has, I do
2 accept her characterization that what she has
3 come forward with is a compromise and it is
4 vastly different from what she originally
5 brought to the table.
6 And so I do not know whether there are
7 some things that can be done to solve this, and
8 maybe there are some minor tweaks, but I would
9 just suggest that, at least from my perspective,
10 someone who has been working with Senator
11 Lincoln on this bill and has been dealing with
12 this issue for quite some time, great progress
13 has been made from my estimation on this and
14 that we are not far from where we need to be if
15 we are not there already. And so I would
16 certainly hope that if we are not going to have
17 a vote today I can tell you I will defer to my
18 chairman, but I will tell my chairman and my
19 ranking member that I am going to be with
20 Senator Lincoln after this if we cannot find a
21 better agreement.
22 Senator Lincoln. I want to make sure that
23 I have got the gentleman from Pennsylvania
24 correct. You are going to defer to the
25 chairman today?

1 Senator Santorum. I am going to defer to
2 my cairman today since this is my first markup.
3 And I do not want to upset my chairman on my
4 first markup.
5 (Laughter)
6 Senator Santorum. So, I will defer today,
7 but that is long as my deference will hold.
8 The Chairman. I thought I had deference
9 to the Senator from Pennsylvania since we are
10 marking up his bill on Thursday at the committee.
11 (Laughter)
12 The Chairman. So I do not know what more
13 I have to do for a new Senator from
14 Pennsylvania.
15 Senator Santorum. I appreciate that.
16 (Laughter)
17 Senator Lincoln. Well, Mr. Chairman, I
18 appreciate everyone's willingness to continue
19 to work on this issue.
20 I agree with Senator Santorum. I do not
21 know how much more we can do. I have been
22 willing, really, to come and make as many
23 compromises as has been asked. And again, it
24 is truly our intent in this bill and in this
25 committee to make available the opportunity for

1 individuals and companies to make an
2 investment in this country to charitable
3 contributions. This is an important way that we
4 can make that happen.
5 We have worked from every detail. We have
6 worked with Treasury, we have worked with the
7 committee. We have done everything that we
8 possibly could do to make sure that this is
9 going to be something that does not fall in the
10 category of abuses or excess but that, more
11 importantly, works towards the benefit of what
12 we are trying to achieve in this bill.
13 So, with all due respect --
14 Senator Lott. Mr. Chairman, would the
15 Senator yield?
16 The Chairman. The Senator from
17 Mississippi.
18 Senator Lincoln. Sure.
19 Senator Lott. If you would yield.
20 Senator Lincoln. Absolutely.
21 Senator Lott. I am going to be with you
22 on this. And I think it is important that we
23 have this in the final version. And as I noted,
24 in committee sometime when the leadership
25 decides that they are going to join hands and

1 oppose an amendment it makes it very difficult
2 even when you have people that in spirit support
3 it.
4 But I would like to urge the leadership
5 here to do a little bit more than what they have
6 committed to. They have committed to work with
7 you.
8 A commitment that something is going to be
9 in this bill in this area would be more
10 significant and perhaps would give us a way to
11 abort an amendment right now.
12 But I just want to pledge to the Senator
13 from Arkansas that when we get to the floor this
14 provisions is going to be in there or we are
15 going to have a huge fight over the whole bill.
16 So, I hope that we could get a little bit
17 more commitment than just to work with the
18 Senator, because what that means is in the end,
19 cut it down to $30 million or else it is not
20 going to be included. And if you cut it down to
21 $30 million I do not know what the value would
22 be left.
23 And so I guess that I am arguing both ways.
24 I just think we need a little stronger
25 committment from the leadership. And if you

1 could get that then I would encourage the
2 Senator to lets hold off and make sure it is in
3 there on the floor.
4 Senator Lincoln. I thank my neighbor from
5 Mississippi.
6 And, Mr. Chairman, if the problem is the
7 issue of paying for the proposal that we have,
8 I do not have a problem with the potential pay
9 for. I mean, I think that we could do that with
10 whatever necessary increases in the penalties
11 that are already in the bill could provide for
12 in terms of pay for. So, I would be glad to do
13 that.
14 And I do thank the gentleman from
15 Mississippi for his comments.
16 And, Mr. Chairman, I don't like to appear
17 to be stubborn, but I suppose the reason that I
18 have been stubborn today is because the
19 commitment that I got last year was that we would
20 work together. And we did work together but we
21 did not get anywhere. And I appreciate what the
22 gentleman from Mississippi has said, which is if
23 we do have a commitment that we are going to get
24 something in the bill then I can certainly defer
25 to the chairman.

1 The Chairman. Can I ask you, don't you
2 think that we delivered on our commitment last
3 year when it was in the manager's amendment?
4 Senator Lincoln. Yes, sir, from your
5 standpoint. But we never got an okay from
6 Treasury that it was going to be something that
7 would work out.
8 The Chairman. Treasury is the other branch
9 of government.
10 (Laughter)
11 The Chairman. What you have got to worry
12 about is me and Senator Baucus.
13 (Laughter)
14 Senator Lincoln. Well, if that commitment
15 is the same, that you are willing to get
16 something in a final bill --
17 The Chairman. Let me put it in the light
18 of something that I think you understand.
19 There is a little bit more about this that
20 I have to understand, and you will get my support
21 on this when I understand it as much as I
22 understand the soy-diesel tax credit that you and
23 I worked on together. We got that done.
24 Senator Lincoln. Well, I have got to tell
25 you, Mr. Chairman, you are a good partner to work

with and I appreciate that. And with that commitment that, as long as I can provide you the information to update you and bring you up to speed as necessary I will withdraw my amendment, with that commitment and assurance that there will be something in the final package and that we can work together to make that happen.

The Chairman. Thank you very much.

And with the business of the committee being concluded, the meeting is adjourned.

(Whereupon, at 11:19 a.m., the meeting was concluded.)

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UNITED STATES SENATE
COMMITTEE ON FINANCE

Charles E. Grassley, Chairman

Wednesday, February 5, 2003
10:00 a.m.
215 Dirksen Senate Office Building

Agenda for Business Meeting

I. An original bill entitled, the "Armed Forces Tax Fairness Act of 2003".

II. An original bill entitled, the "CARE Act of 2003".

exec

Committee On Finance

Max Baucus, Ranking Member

NEWS RELEASE http://finance.senate.gov

For Immediate Release
Wednesday, February 5, 2003

Contacts: Laura Hayes, Lara Birkes
202-224-4515

Markup of CARE Act, Tax Shelters, and Military Tax Legislation

Senator Grassley, I commend you for holding today's markup to advance legislation that the Committee approved last year. They were good measures then; they remain so today.

Both measures – the "Armed Forces Tax Fairness Act" and the "CARE Act" – enjoy wide-spread, bipartisan support. They were overwhelmingly approved by the Committee last year. Unfortunately, we were unable to get these bills enacted into law before we adjourned. I share the Chairman's hope that we will be more successful this year.

I am particularly pleased that both bills continue to be fully offset and that we will not be adding to the growing deficit. More importantly, the offsets are important in their own right. They will shut down tax law noncompliance – abusive tax shelters – and help ensure that everyone is paying their fair share.

Let me say a few words about each measure. First, the "CARE Act." The tax provisions in the CARE Act will encourage additional giving to the organizations that serve those in need. With the sluggish economy, charitable giving has not kept pace with the increasing demand for services from these organizations.

For example, in my home state, the Montana Food Bank Network serves 1.5 million meals, including meals to almost 200,000 children. More and more people are relying on food banks and soup kitchens for their daily nourishment. Demand is outstripping supply.

I am glad today's mark includes additional incentives to spur donations of surplus food. There are a number of provisions contained in the CARE Act that will help charities help our communities. Books for literacy programs. Computers for schools. Contributions of open space for conservation.

The mark also contains a number of provisions to improve the oversight of tax-exempt organizations. The bill will provide for greater sunshine on charitable activities. State officials will have greater access to information allowing them to ensure that contributions are used for their intended purpose.

Second, the "Armed Forces Tax Fairness Act." Our country is preparing for war with Iraq. Our service personnel shouldn't have to fight the tax code when they're serving our country.

Under this measure, American military personnel would get new tax relief.

- Death benefits paid to military survivors would be fully exempt from tax.
- The capital gain rules would be modified for home sales by service members called away to duty.
- Military reservists and National Guard personnel would be allowed to deduct their service-related travel expenses.

Last year, the Senate voted without dissent to pass this bill. I hope we can move quickly to provide relief to those who are prepared to make the ultimate sacrifice to protect us.

Mr. Chairman, yesterday, I attended the Memorial Service for the *Columbia* shuttle astronauts in Huston. It was a wonderful tribute to America's fallen heroes.

Upon return, I introduced legislation to provide assistance to the astronaut's families. The relief package would essentially provide the same benefits as families of military personnel who die in the line of duty. I'm hopeful we can move on this measure this morning.

Let me turn to offsets. The military tax relief bill would be paid for by a tax on individuals who renounce their U.S. citizenship. Specifically, the bill would provide that expatiates pay the tax they owe on the day they relinquish their citizenship. Treasury would be given new tools to make sure that assets do not move with the expatriate before tax has been paid.

The CARE Act would be paid for with tax shelter legislation developed by the Committee over the past four years. It is time to put a stop to the unsavory practice of mining the tax code for abusive shelters.

For years, the Finance Committee has been committed to helping combat these carefully engineered transactions. They have little or no economic substance. They are designed to achieve unwarranted tax benefits rather than business profit. They place honest corporate competitors at a disadvantage.

Treasury believes that if a taxpayer feels comfortable entering into a transaction, if a promoter feels comfortable selling a transactions, and an advisor feels comfortable

recommending a transaction, they should all feel comfortable detailing the transaction for the IRS. I agree. This legislation reinforces Treasury's shelter program and will put the brakes on these abusive shelters.

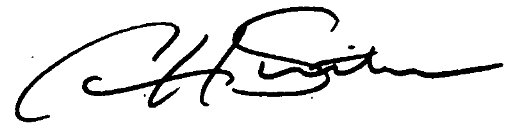
Under the mark, promoters, advisors and taxpayers would be subject to stiff penalties for failing to acknowledge these transactions to the IRS.

The mark would also eliminate abusive tax shelters by denying tax benefits claimed to arise from transactions that do not meet a heightened economic substance requirement. Under the mark, taxpayers will have to enter into transactions for legitimate economic and business reasons and not for purely tax avoidance.

The shelter legislation is an important first step. The Joint Committee on Taxation is nearing completion of its investigation into Enron. Additional steps may be needed. I am confident that this Committee will not hesitate to take further action.

The legislation does not include the inversions bill Chairman Grassley and I pushed last year. But businesses affected by the inversions legislation should not breathe too easily. I urge the Chairman to bring this legislation before the Committee expeditiously.

Thank you again Mr. Chairman for holding today's markup. I look forward to working with you, and members on the Committee, to see these measures enacted into law.



OPENING STATEMENT

CARE ACT
Military Tax Fairness Act
Senator Gordon H. Smith
2/5/03

- I am pleased to support the CARE Act and congratulate the Chairman and Ranking Member for their recognition and quick action on the tax portion of this important legislation.

- I also commend the Chairman for his work on The Armed Services Tax Fairness Act of 2003. I am pleased to be an original cosponsor of this package that brings tax fairness and equity to our men and women in uniform.

- This bill protects members of the Armed Services and their families from paying taxes on death gratuity payments. The bill also allows those on active duty to take advantage of the capital gains tax relief on home sales, even though they may be required to move frequently.

- I hope that all my colleagues will support these bills in Committee and on the Senate floor.

- Mr. Chairman, I am also an original cosponsor of the CARE Act - legislation that will help our nation's charities respond to very real and pressing social problems.

- I believe this legislation will successfully leverage support and marshal resources for helping the less fortunate. This nation's economy has been struggling for the last year and a half - and the tragedy of 9/11 only worsened the situation.

- Oregon particularly is undergoing a long economic downturn - our unemployment rate has been one of the highest in the nation for well over a year. During a period like this, charities - charitable organizations face new challenges in both fund-raising and the number of new applicants for critical services.

- The CARE Act will help community and faith-based groups reach out to improve those in need in Oregon and across the nation. I strongly believe that this boost is needed by all aspects of the charitable giving community and will have an immediate impact. Today in Committee we will vote out legislation that will:

  1. Create tax incentives to promote greater charitable giving;

2. Create better innovative programs to help Oregonians struggling in today's economy.
3. Provide faith-based organizations with the ability to reach out and provide services where current programs may not be able to meet the growing needs of our society.

- Mr. Chairman, I look for a speedy resolution in both the House and Senate on this important legislation and hope that the President will be able to sign it into law at the soonest possible opportunity.

Smith Amendment

- Mr. Chairman, I have filed an amendment that would allow non-profit organizations to issue tax-exempt bonds to finance the purchase of forested lands, so that the land can be managed for conservation purposes, with a limited amount of harvest.

- This amendment is identical to a provision that Senator Baucus included in the Chairman's mark during consideration of the CARE package in this committee just last year

- In consultation with your staff, I have agreed to enter into a colloquy with the Chairman on this issue and withdraw the amendment based on a commitment by Finance Committee staff to work towards a resolution during floor consideration.

- I thank the Chairman for his consideration of this important issue and his staff for their willingness to work with me and my staff.

Statement
Sen. Rick Santorum
Senate Finance Committee
on the CARE Act
February 5, 2003

Mr. Chairman, I want to thank you for your leadership of this important charitable initiative and this important priority of President Bush. Just last week, the President called again on Congress to pass his Faith-Based Initiative. I would also like to thank the Ranking Member for supporting expedited consideration of the tax provisions of The Charity Aid, Recovery and Empowerment (CARE) Act of 2003, S. 272, this year by the Finance Committee. I strongly support the CARE Act, which I introduced last week with Senator Lieberman, Chairman Grassley, Senator Bayh, Majority Leader Frist, Senator Bill Nelson, Senator Smith, Senator Miller, Senator Hatch and other bipartisan cosponsors. The CARE Act was introduced in the last Congress and was considered by the Senate Finance Committee but was never debated on the floor of the Senate because of repeated objections to unanimous consent requests to bring up the bill. The time has come to move this important resources package forward to help those in need and to assist those charitable organizations walking alongside them to restore families and communities. I am pleased that we are taking a significant step in that direction today.

The CARE Act reflects America's renewed spirit of unity, community and responsibility in the wake of the September 11 terrorist attacks and the new challenges that have faced us since then. It is an important legislative package to encourage giving, saving, and fairness which builds on the President's Faith-Based and Community Initiative. This bipartisan consensus bill seeks to harness the potential of charitable organizations in order to better serve the most needy members of our society in partnership with government efforts. A coalition of more than 1,600 national and grassroots charitable organizations helping those in need endorsed nearly similar legislation last year. The bill offers incentives to individuals and corporations to increase charitable giving, rewards low-income citizens who choose to save, and insists on fairness for faith-based organizations by leveling the playing field so that non-governmental organizations involved in charitable activities may compete for government funds to provide social service delivery.

Throughout our country many social entrepreneurs and community healers are making a difference in the lives of those who are struggling and in the neighborhoods and communities seeking to revive themselves in the face of poverty, crime, failing schools, and unemployment. Many of these heroic individuals and organizations are also motivated by faith. For example, more than 75% of the food banks across our nation have a religious affiliation.

The CARE Act attempts to help with the current challenges that charitable organizations are facing and expand the base of private and governmental resources well into the future to better help those in need such as the hungry, the homeless, the addicted, the sick, at-risk children, and the elderly through a variety of tools and resources. The tremendous outpouring of generosity by Americans after September 11 is to be celebrated. Yet the reality is that many needs remain unmet throughout the country as some charitable giving has been redirected and

other human needs have increased. Unfortunately, as a result of the tragic events of September 11, a struggling stock market, and the recent recession, numerous charitable organizations have suffered financial losses--in some cases, up to 20 percent or more. The bill seeks to expand the capacity of the voluntary and charitable sectors in this country which is one of the greatest strengths and traditions of our country.

GIVING: The CARE Act seeks to address these needs through a number of expanded tax incentives. The bill restores a charitable tax deduction for the 84 million Americans who do not itemize for a maximum deduction of up to $250 for individual taxpayers and $500 for couples for charitable giving beyond a base level of $250 for individuals and $500 for couples. To encourage larger donations, IRA holders will also be allowed to make charitable contributions without tax penalties. Corporations and farmers will be offered tax deductions for their donations of food to charity, amounting to $2 billion dollars in incentives over 10 years in order to provide more food to the needy rather than letting it go to waste. A deduction is also provided for contributions of books to schools.

SAVING: The CARE Act also attempts to narrow the gap between the rich and the poor. Through Individual Development Accounts (IDAs), low-income Americans are encouraged to save and build assets and provided training in financial education. These special savings accounts offer matching contributions from the sponsoring bank or community organization reimbursed through a federal tax credit, on the condition that the proceeds go to buying a home, starting a business or paying for post-secondary education. Low-income Americans are now being given the possibility of sharing in the American dream. The provision would provide for a phased-in 300,000 savings accounts for a national demonstration.

FAIRNESS: The CARE Act helps smaller faith and community-based organizations. Through the Compassion Capital Fund, it provides these community healers with additional resources for technical assistance such as enabling incorporation, grant writing and accounting skills. It also allows social service agencies with experience in administering government contracts to play an intermediate role between government agencies and smaller charities. These provisions will help smaller faith-based charities to survive and to grow into viable charitable organizations. The legislation also expands resources through significant increases in the Social Services Block Grant (SSBG) funds of more than $1.3 billion.

Despite the positive advantages of the CARE Act, some are wary of the impact of its provisions. Some critics on the left argue that the provisions violate the Constitution by fusing church and state because preferential treatment is given to religious groups. This is false. Instead, the CARE Act gives religious charitable organizations the opportunity to compete with secular organizations for federal funding by strengthening the principle of nondiscrimination against faith-based organizations through the codification of basic and commonsense equal treatment protections. The proposed legislation creates a more level playing field for faith-based charities by ensuring that they cannot be discriminated against in applying for government funds because of their religious nature by ensuring the right to maintain religious icons, religious names, religious governance criteria, and religious references in founding documents. The provision also

makes clear that the mere fact that a faith-based provider has not previously received government funding does not disqualify them from consideration.

On the other hand, some critics on the right argue that the CARE Act will undermine the religious nature of faith-based organizations by restricting their abilities to promote religious values and by controlling the hiring process. But the moral integrity of faith-based organizations is protected by the Act. Though the question of hiring is not addressed in the bill – current laws will continue to apply – the equal treatment for non-govermental organizations provision in the bill assures that organizations which seek federal funds are not required to remove religious symbols, change their names, or change their governing structures to qualify. Hence, faith-based organizations can still adhere to the values and beliefs that motivate, make them unique, and reflect the diversity of America as they serve those in need. The initiative does not require faith-based organizations to participate with government funds in their efforts to serve those in need, it merely gives them the option if they feel that doing so is consistent with their mission and prevents the government from excluding qualified social service providers merely because they are faith-based in character.

The CARE Act is supported by both Democrats and Republicans. The time has come to get this legislation on the President's desk as he has repeatedly called for. The former Senate Majority Leader, Tom Daschle, wrote shortly after the bill's introduction last year that "the CARE Act is not a Republican or Democratic plan. It is a bipartisan proposal that strikes the right balance between harnessing the best forces of faith in our public life without infringing on the First Amendment ... I look forward to working with President Bush and my congressional colleagues to get this proposal signed into law."

The ongoing challenges facing the charitable community serving those in need are significant. The time has come for the Senate to pass this important legislation. The Senate Finance Committee takes an important step forward today. The CARE Act advances our common interest in turning the immense spirit of volunteerism and civic duty in our country toward building strong communities. The Act's ultimate goal is to help those most in need in our society--the poor, the hopeless and the destitute. I thank my colleagues for their support and the many generous Americans working to transform lives and improve communities for the difference that they make each day.

DESCRIPTION OF THE CHAIRMAN'S MARK OF THE "ARMED FORCES TAX FAIRNESS ACT OF 2003"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on February 5, 2003

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

February 3, 2003
JCX-2-03

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INTRODUCTION

This document[1], prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's Mark of the "Armed Forces Tax Fairness Act of 2003." The Senate Committee on Finance has scheduled a markup of this proposal for February 5, 2003.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Mark of the "Armed Forces Tax Fairness Act of 2003"* (JCX-2-03), February 3, 2003.

I. IMPROVING TAX EQUITY FOR MILITARY PERSONNEL

A. Exclusion of Gain on Sale of a Principal Residence by a Member of the Uniformed Services or the Foreign Service

Present Law

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000, if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to members of the uniformed services or the Foreign Service of the United States.

Description of Proposal

Under the proposal, an individual may elect to suspend for a maximum of ten years the five-year test period for ownership and use during certain absences due to service in the uniformed services, or Foreign Service of the United States. The uniformed services include: (1) the Armed forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to ten years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty as a member of the uniformed services, or in Foreign Service of the United States. For these purposes, qualified official extended duty is any period of extended duty by a member of the uniformed services, or the Foreign Service of the United States while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period. The election may be made with respect to only one property for a suspension period.

Effective Date

The provision is effective for sales or exchanges after May 6, 1997.

B. Exclusion from Gross Income of Certain Death Gratuity Payments

Present Law

Present law provides that qualified military benefits are not included in gross income. Generally, a qualified military benefit is any allowance or in-kind benefit (other than personal use of a vehicle) which: (1) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services; and (2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date. Generally, other than certain cost of living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion from gross income. Qualified military benefits include certain death gratuities.

Description of Proposal

The proposal extends the exclusion from gross income to any adjustment to the amount of the death gratuity payable under Chapter 75 of Title 10 of the United States Code with respect to the death of certain members of the Armed services on active duty, inactive duty training, or engaged in authorized travel.

Effective Date

The provision is effective with respect to deaths occurring after September 10, 2001.

C. Exclusion for Amounts Received Under Department of Defense Homeowners Assistance Program

Present Law

HAP payment

The Department of Defense Homeowners Assistance Program ("HAP") provides payments to certain employees and members of the Armed Forces to offset the adverse effects on housing values that result from military base realignment or closure. The payments are authorized under the provisions of Title 42 U.S.C. section 3374.

HAP provides payments to eligible individuals who may, in general, either (1) receive a cash payment as compensation for losses that may be or have been sustained in a private sale, in an amount not to exceed the difference between (A) 95 percent of the fair market value of their property prior to public announcement of intention to close all or part of the military base or installation and (B) the fair market value of such property at the time of the sale, or (2) receive, as the purchase price for their property, an amount not to exceed 90 percent of the prior fair market value as such value is determined by the Secretary of Defense, or the amount of the outstanding mortgages.

Tax treatment

Unless specifically excluded, gross income for Federal income tax purposes includes all income from whatever source derived. Amounts received under HAP are received in connection with the performance of services, and thus are includable in gross income as compensation for services. Additionally, such payments are "wages" for Federal Insurance Contributions Act tax purposes (including Medicare).

Description of Proposal

The proposal exempts from gross income amounts received under the Homeowners Assistance Program (as in effect on the date of enactment of this proposal). Amounts received under the program also are not considered wages for Federal Insurance Contributions Act tax purposes (including Medicare).

Effective Date

The provision is effective for payments made after the date of enactment.

D. Expansion of Combat Zone Filing Rules to Contingency Operations

Present Law

General time limits for filing tax returns

Individuals generally must file their Federal income tax returns by April 15 of the year following the close of a taxable year. The Secretary may grant reasonable extensions of time for filing such returns. Treasury regulations provide an additional automatic two-month extension (until June 15 for calendar-year individuals) for United States citizens and residents in military or naval service on duty on April 15 of the following year (the otherwise applicable due date of the return) outside the United States. No action is necessary to apply for this extension, but taxpayers must indicate on their returns (when filed) that they are claiming this extension. Unlike most extensions of time to file, this extension applies to both filing returns and paying the tax due.

Treasury regulations also provide, upon application on the proper form, an automatic four-month extension (until August 15 for calendar-year individuals) for any individual timely filing that form and paying the amount of tax estimated to be due.

In general, individuals must make quarterly estimated tax payments by April 15, June 15, September 15, and January 15 of the following taxable year. Wage withholding is considered to be a payment of estimated taxes.

Suspension of time periods

In general, the period of time for performing various acts under the Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, is suspended for any individual serving in the Armed Forces of the United States in an area designated as a "combat zone" during the period of combatant activities. An individual who becomes a prisoner of war is considered to continue in active service and is therefore also eligible for these suspension of time provisions. The suspension of time also applies to an individual serving in support of such Armed Forces in the combat zone, such as Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces in support of those Forces. The designation of a combat zone must be made by the President in an Executive Order. The President must also designate the period of combatant activities in the combat zone (the starting date and the termination date of combat).

The suspension of time encompasses the period of service in the combat zone during the period of combatant activities in the zone, as well as (1) any time of continuous qualified hospitalization resulting from injury received in the combat zone[2] or (2) time in missing in action status, plus the next 180 days.

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[2] Two special rules apply to continuous hospitalization inside the United States. First, the suspension of time provisions based on continuous hospitalization inside the United States are applicable only to the hospitalized individual; they are not applicable to the spouse of such

The suspension of time applies to the following acts:

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

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

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

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

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

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

(7) Assessment of any tax;

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

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

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

(11) Any other act required or permitted under the internal revenue laws specified by the Secretary of the Treasury.

Individuals may, if they choose, perform any of these acts during the period of suspension. Spouses of qualifying individuals are entitled to the same suspension of time, except that the spouse is ineligible for this suspension for any taxable year beginning more than two years after the date of termination of combatant activities in the combat zone.

Description of Proposal

The proposal applies the special suspension of time period rules to persons deployed outside the United States away from the individual's permanent duty station while participating in an operation designated by the Secretary of Defense as a contingency operation or that becomes a contingency operation. A contingency operation is defined[3] as a military operation

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individual. Second, in no event do the suspension of time provisions based on continuous hospitalization inside the United States extend beyond five years from the date the individual returns to the United States. These two special rules do not apply to continuous hospitalization outside the United States.

[3] The definition is done by cross-reference to 10 U.S.C. 101.

that is designated by the Secretary of Defense as an operation in which members of the Armed forces are or may become involved in military actions, operations, or hostilities against an enemy of the United States or against an opposing military force, or results in the call or order to (or retention on) active duty of members of the uniformed services during a war or a national emergency declared by the President or Congress.

Effective Date

The provision applies to any period for performing an act that has not expired before the date of enactment.

E. Modification of Membership Requirement for Exemption from Tax for Certain Veterans' Organizations

Present Law

Under present law, a veterans' organization as described in section 501(c)(19) of the Code generally is exempt from taxation. The Code defines such an organization as a post or organization of past or present members of the Armed Forces of the United States (1) that is organized in the United States or any of its possessions; (2) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and (3) that meets certain membership requirements. The membership requirements are that (1) at least 75 percent of the organization's members are past or present members of the Armed Forces of the United States, and (2) substantially all of the remaining members are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets. No more than 2.5 percent of an organization's total members may consist of individuals who are not veterans, cadets, or spouses, widows, or widowers of such individuals.

Contributions to an organization described in section 501(c)(19) may be deductible for Federal income or gift tax purposes if the organization is a post or organization of war veterans.

Description of Proposal

The proposal permits ancestors or lineal descendants of past or present members of the Armed Forces of the United States or of cadets to qualify as members for purposes of the "substantially all" test. The proposal does not change the requirement that 75 percent of the organization's members must be past or present members of the Armed Forces of the United States.

Effective Date

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

F. Clarification of Treatment of Certain Dependent Care Assistance Programs Provided to Members of the Uniformed Services of the United States

Present Law

Present law provides that qualified military benefits are not included in gross income. Generally, a qualified military benefit is any allowance or in-kind benefit (other than personal use of a vehicle) which: (1) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services; and (2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date. Generally, other than certain cost of living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion from gross income.

Description of Proposal

The proposal clarifies that dependent care assistance provided under a dependent care assistance program (as in effect on the date of enactment of this proposal) for a member of the uniformed services by reason of such member's status or service as a member of the uniformed services is excludable from gross income as a qualified military benefit subject to the present-law rules. The uniformed services include: (1) the Armed forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. Amounts received under the program also are not considered wages for Federal Insurance Contributions Act tax purposes (including Medicare).

Effective Date

The provision is effective for taxable years beginning after December 31, 2002. No inference is intended as to the tax treatment of such amounts for prior taxable years.

G. Treatment of Service Academy Appointments as Scholarships for Purposes of Qualified Tuition Programs and Coverdell Education Savings Accounts

Present Law

The Code provides tax-exempt status to qualified tuition programs, meaning programs established and maintained by a State or agency or instrumentality thereof or by one or more eligible educational institutions under which a person (1) may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary, or (2) in the case of a program established by and maintained by a State or agency or instrumentality thereof, may make contributions to an account which is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account. Contributions to qualified tuition programs may be made only in cash. Qualified tuition programs must have adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of amounts necessary to provide for the qualified higher education expenses of the beneficiary.

The Code provides tax-exempt status to Coverdell education savings accounts ("ESAs"), meaning certain trusts or custodial accounts which are created or organized in the United States exclusively for the purpose of paying the qualified education expenses of a designated beneficiary. Contributions to ESAs may be made only in cash. Annual contributions to ESAs may not exceed $2,000 per beneficiary (except in cases involving certain tax-free rollovers) and may not be made after the designated beneficiary reaches age 18.

Earnings on contributions to an ESA or qualified tuition program generally are subject to tax when withdrawn. However, distributions from an ESA or qualified tuition program are excludable from the gross income of the distributee to the extent that the total distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made.

If the qualified education expenses of the beneficiary for the year are less than the total amount of the distribution from an ESA or qualified tuition program, then the qualified education expenses are deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. In such a case, only a portion of the earnings is excludable (i.e., the portion of the earnings based on the ratio that the qualified education expenses bear to the total amount of the distribution) and the remaining portion of the earnings is includible in the beneficiary's gross income.

The earnings portion of a distribution from an ESA or qualified tuition program that is includible in income is generally subject to an additional 10 percent tax. The 10 percent additional tax does not apply if a distribution is made on account of the death or disability of the designated beneficiary, or on account of a scholarship received by the designated beneficiary (to the extent it does not exceed the amount of the scholarship).

Service obligations are required of recipients of appointments to the United States Military Academy, the United States Naval Academy, the United States Air Force Academy, the United States Coast Guard Academy, or the United States Merchant Marine Academy. Because of these service obligations, appointments to the Academies are not considered scholarships for purposes of the waiver of the additional 10 percent tax on withdrawals from ESAs and qualified tuition programs that are not used for qualified education purposes.

Description of Proposal

The proposal permits penalty free withdrawals from Coverdell education savings accounts and qualified tuition programs made on account of the attendance of the account holder or beneficiary at the United States Military Academy, the United States Naval Academy, the United States Air Force Academy, the United States Coast Guard Academy, or the United States Merchant Marine Academy.

The amount of funds that can be withdrawn penalty free is limited to the costs of advanced education as defined in 10 United States Code section 2005(e)(3) (as in effect on the date of the enactment of the proposal) at such Academies.

Effective Date

The provision applies to taxable years beginning after December 31, 2002.

H. Suspension of Tax-Exempt Status of Terrorist Organizations

Present Law

Under present law, the Internal Revenue Service generally issues a letter revoking recognition of an organization's tax-exempt status only after (1) conducting an examination of the organization, (2) issuing a letter to the organization proposing revocation, and (3) allowing the organization to exhaust the administrative appeal rights that follow the issuance of the proposed revocation letter. In the case of an organization described in section 501(c)(3), the revocation letter immediately is subject to judicial review under the declaratory judgment procedures of section 7428. To sustain a revocation of tax-exempt status under section 7428, the IRS must demonstrate that the organization is no longer entitled to exemption. There is no procedure under present law for the IRS to suspend the tax-exempt status of an organization.

To combat terrorism, the Federal government has designated a number of organizations as terrorist organizations or supporters of terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945.

Description of Proposal

The proposal suspends the tax-exempt status of an organization that is exempt from tax under section 501(a) for any period during which the organization is designated or identified by U.S. Federal authorities as a terrorist organization or supporter of terrorism. The proposal also makes such an organization ineligible to apply for tax exemption under section 501(a). The period of suspension runs from the date the organization is first designated or identified to the date when all designations or identifications with respect to the organization have been rescinded pursuant to the law or Executive order under which the designation or identification was made.

The proposal describes a terrorist organization as an organization that has been designated or otherwise individually identified (1) as a terrorist organization or foreign terrorist organization under the authority of section 212(a)(3)(B)(vi)(II) or section 219 of the Immigration and Nationality Act; (2) in or pursuant to an Executive order that is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive order that refers to the proposal and is issued under the authority of any Federal law if the organization is designated or otherwise individually identified in or pursuant to such Executive order as supporting or engaging in terrorist activity (as defined in section 212(a)(3)(B) of the Immigration and Nationality Act) or supporting terrorism (as defined in section 140(d)(2) of the Foreign Relations Authorization Act, Fiscal Years 1988 and 1989). During the period of suspension, no deduction is allowed under the proposal for any contribution to a terrorist organization under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522.

No organization or other person may challenge, under section 7428 or any other provision of law, in any administrative or judicial proceeding relating to the Federal tax liability

of such organization or other person, the suspension of tax-exemption, the ineligibility to apply for tax-exemption, a designation or identification described above, the timing of the period of suspension, or a denial of deduction described above. The suspended organization may maintain other suits or administrative actions against the agency or agencies that designated or identified the organization, for the purpose of challenging such designation or identification (but not the suspension of tax-exempt status under this provision).

If the tax-exemption of an organization is suspended and each designation and identification that has been made with respect to the organization is determined to be erroneous pursuant to the law or Executive order making the designation or identification, and such erroneous designation results in an overpayment of income tax for any taxable year with respect to such organization, a credit or refund (with interest) with respect to such overpayment shall be made. If the operation of any law or rule of law (including res judicata) prevents the credit or refund at any time, the credit or refund may nevertheless be allowed or made if the claim for such credit or refund is filed before the close of the one-year period beginning on the date that the last remaining designation or identification with respect to the organization is determined to be erroneous.

The proposal directs the IRS to update the listings of tax-exempt organizations to take account of organizations that have had their exemption suspended and to publish notice to taxpayers of the suspension of an organization's tax-exemption and the fact that contributions to such organization are not deductible during the period of suspension.

Effective Date

The proposal is effective on the date of enactment.

I. Above-the-Line Deduction for Overnight Travel Expenses of National Guard and Reserve Members

Present Law

National Guard and Reserve members may claim itemized deductions for their nonreimbursable expenses for transportation, meals, and lodging when they must travel away from home (and stay overnight) to attend National Guard and Reserve meetings. These overnight travel expenses are combined with other miscellaneous itemized deductions on Schedule A of the individual's income tax return and are deductible only to the extent that the aggregate of these deductions exceeds two percent of the taxpayer's adjusted gross income. No deduction is generally permitted for commuting expenses to and from drill meetings.

Description of Proposal

The proposal provides an above-the-line deduction for the overnight transportation, meals, and lodging expenses of National Guard and Reserve members who must travel away from home more than 100 miles (and stay overnight) to attend National Guard and Reserve meetings. Accordingly, these individuals incurring these expenses can deduct them from gross income regardless of whether they itemize their deductions. The amount of the expenses that may be deducted may not exceed the general Federal Government per diem rate applicable to that locale.

Effective Date

The provision is effective with respect to amounts paid or incurred after December 31, 2002.

II. REVENUE PROVISIONS

A. Extension of IRS User Fees

Present Law

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104-117[4] extended the statutory authorization for these user fees[5] through September 30, 2003.

Description of Proposal

The proposal extends the statutory authorization for these user fees through September 30, 2013. The proposal also moves the statutory authorization for these fees into the Code.

Effective Date

The provision, including moving the statutory authorization for these fees into the Code and repealing the off-Code statutory authorization for these fees, is effective for requests made after the date of enactment.

[4] An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996).

[5] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Public Law 100-203, December 22, 1987).

B. Authorize IRS to Enter into Installment Agreements that Provide for Partial Payment

Present Law

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed. An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

Prior to 1998, the IRS administratively entered into installment agreements that provided for partial payment (rather than full payment) of the total amount owed over the period of the agreement. In that year, the IRS Chief Counsel issued a memorandum concluding that partial payment installment agreements were not permitted.

Description of Proposal

The proposal clarifies that the IRS is authorized to enter into installment agreements with taxpayers that do not provide for full payment of the taxpayer's liability over the life of the agreement. The proposal requires the IRS to review partial payment installment agreements at least every two years. The primary purpose of this review is to determine whether the financial condition of the taxpayer has significantly changed so as to warrant an increase in the value of the payments being made.

Effective Date

The provision is effective for installment agreements entered into on or after the date of enactment.

C. Impose Mark-to-Market Tax on Individuals Who Expatriate

Present Law

In general

U.S. citizens and residents generally are subject to U.S. income taxation on their worldwide income. The U.S. tax may be reduced or offset by a credit allowed for foreign income taxes paid with respect to foreign-source income. Nonresidents who are not U.S. citizens are taxed at a flat rate of 30 percent (or a lower treaty rate) on certain types of passive income derived from U.S. sources, and at regular graduated rates on net profits derived from a U.S. business.

Income tax rules with respect to expatriates

An individual who relinquishes his or her U.S. citizenship or terminates his or her U.S. residency with a principal purpose of avoiding U.S. taxes is subject to an alternative method of income taxation for the 10 taxable years ending after the expatriation or residency termination under section 877. The alternative method of taxation for expatriates modifies the rules generally applicable to the taxation of nonresident noncitizens in several ways. First, the individual is subject to tax on his or her U.S.-source income at the rates applicable to U.S. citizens rather than the rates applicable to other nonresident noncitizens. Unlike U.S. citizens, however, individuals subject to section 877 are not taxed on foreign-source income. Second, the scope of items treated as U.S.-source income for section 877 purposes is broader than those items generally considered to be U.S.-source income under the Code.[6] Third, individuals subject to section 877 are taxed on exchanges of certain types of property that give rise to U.S.-source income for property that gives rise to foreign-source income.[7] Fourth, an individual subject to section 877 who contributes property to a controlled foreign corporation is treated as receiving income or gain from such property directly and is taxable on such income or gain. The alternative method of taxation for expatriates applies only if it results in a higher U.S. tax

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[6] For example, gains on the sale or exchange of personal property located in the United States, and gains on the sale or exchange of stocks and securities issued by U.S. persons, generally are not considered to be U.S.-source income under the Code. Thus, such gains would not be taxable to a nonresident noncitizen. However, if an individual is subject to the alternative regime under sec. 877, such gains are treated as U.S.-source income with respect to that individual.

[7] For example, a former citizen who is subject to the alternative tax regime and who removes appreciated artwork that he or she owns from the United States could be subject to immediate U.S. tax on the appreciation. In this regard, the removal from the United States of appreciated tangible personal property having an aggregate fair market value in excess of $250,000 within the 15-year period beginning five years prior to the expatriation will be treated as an "exchange" subject to these rules.

liability than would otherwise be determined if the individual were taxed as a nonresident noncitizen.

The expatriation tax provisions apply to long-term residents of the United States whose U.S. residency is terminated. For this purpose, a long-term resident is any individual who was a lawful permanent resident of the United States for at least 8 out of the 15 taxable years ending with the year in which such termination occurs. In applying the 8-year test, an individual is not considered to be a lawful permanent resident for any year in which the individual is treated as a resident of another country under a treaty tie-breaker rule (and the individual does not elect to waive the benefits of such treaty).

Subject to the exceptions described below, an individual is treated as having expatriated or terminated residency with a principal purpose of avoiding U.S. taxes if either: (1) the individual's average annual U.S. Federal income tax liability for the 5 taxable years ending before the date of the individual's loss of U.S. citizenship or termination of U.S. residency is greater than $100,000 (the "tax liability test"), or (2) the individual's net worth as of the date of such loss or termination is $500,000 or more (the "net worth test"). The dollar amount thresholds contained in the tax liability test and the net worth test are indexed for inflation in the case of a loss of citizenship or termination of residency occurring in any calendar year after 1996. For calendar year 2003, the dollar thresholds for the tax liability test and the net worth test are $122,000 and $608,000, respectively. An individual who falls below these thresholds is not automatically treated as having a principal purpose of tax avoidance, but nevertheless is subject to the expatriation tax provisions if the individual's loss of citizenship or termination of residency in fact did have as one of its principal purposes the avoidance of tax.

Certain exceptions from the treatment that an individual relinquished his or her U.S. citizenship or terminated his or her U.S. residency for tax avoidance purposes may also apply. For example, a U.S. citizen who loses his or her citizenship and who satisfies either the tax liability test or the net worth test (described above) can avoid being deemed to have a principal purpose of tax avoidance if the individual falls within certain categories (such as being a dual citizen) and the individual, within one year from the date of loss of citizenship, submits a ruling request for a determination by the Secretary of the Treasury as to whether such loss had as one of its principal purposes the avoidance of taxes.

<u>Estate tax rules with respect to expatriates</u>

Nonresident noncitizens generally are subject to estate tax on certain transfers of U.S.-situated property at death.[8] Such property includes real estate and tangible property located within the United States. Moreover, for estate tax purposes, stock held by nonresident noncitizens is treated as U.S.-situated if issued by a U.S. corporation.

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[8] The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") repealed the estate tax for estates of decedents dying after December 31, 2009. However, EGTRRA included a "sunset" provision, pursuant to which EGTRRA's provisions (including estate tax repeal) do not apply to estates of decedents dying after December 31, 2010.

Special rules apply to U.S. citizens who relinquish their citizenship and long-term residents who terminate their U.S. residency within the 10 years prior to the date of death, unless the loss of status did not have as one its principal purposes the avoidance of tax (sec. 2107). Under these rules, the decedent's estate includes the proportion of the decedent's stock in a foreign corporation that the fair market value of the U.S.-situs assets owned by the corporation bears to the total assets of the corporation. This rule applies only if (1) the decedent owned, directly, at death 10 percent or more of the combined voting power of all voting stock of the corporation and (2) the decedent owned, directly or indirectly, at death more than 50 percent of the total voting stock of the corporation or more than 50 percent of the total value of all stock of the corporation.

Taxpayers are deemed to have a principal purpose of tax avoidance if they meet the five-year tax liability test or the net worth test, discussed above. Exceptions from this tax avoidance treatment apply in the same circumstances as those described above (relating to certain dual citizens and other individuals who submit a timely and complete ruling request with the IRS as to whether their expatriation or residency termination had a principal purpose of tax avoidance).

Gift tax rules with respect to expatriates

Nonresident noncitizens generally are subject to gift tax on certain transfers by gift of U.S.-situated property. Such property includes real estate and tangible property located within the United States. Unlike the estate tax rules for U.S. stock held by nonresidents, however, nonresident noncitizens generally are not subject to U.S. gift tax on the transfer of intangibles, such as stock or securities, regardless of where such property is situated.

Special rules apply to U.S. citizens who relinquish their U.S. citizenship or long-term residents of the United States who terminate their U.S. residency within the 10 years prior to the date of transfer, unless such loss did not have as one of its principal purposes the avoidance of tax (sec. 2501(a)(3)). Under these rules, nonresident noncitizens are subject to gift tax on transfers of intangibles, such as stock or securities. Taxpayers are deemed to have a principal purpose of tax avoidance if they meet the five-year tax liability test or the net worth test, discussed above. Exceptions from this tax avoidance treatment apply in the same circumstances as those described above (relating to certain dual citizens and other individuals who submit a timely and complete ruling request with the IRS as to whether their expatriation or residency termination had a principal purpose of tax avoidance).

Other tax rules with respect to expatriates

The expatriation tax provisions permit a credit against the U.S. tax imposed under such provisions for any foreign income, gift, estate, or similar taxes paid with respect to the items subject to such taxation. This credit is available only against the tax imposed solely as a result of the expatriation tax provisions, and is not available to be used to offset any other U.S. tax liability.

In addition, certain information reporting requirements apply. Under these rules, a U.S. citizen who loses his or her citizenship is required to provide a statement to the State Department (or other designated government entity) that includes the individual's social security number,

forwarding foreign address, new country of residence and citizenship, a balance sheet in the case of individuals with a net worth of at least $500,000, and such other information as the Secretary may prescribe. The information statement must be provided no later than the earliest day on which the individual (1) renounces the individual's U.S. nationality before a diplomatic or consular officer of the United States, (2) furnishes to the U.S. Department of State a statement of voluntary relinquishment of U.S. nationality confirming an act of expatriation, (3) is issued a certificate of loss of U.S. nationality by the U.S. Department of State, or (4) loses U.S. nationality because the individual's certificate of naturalization is canceled by a U.S. court. The entity to which such statement is to be provided is required to provide to the Secretary of the Treasury copies of all statements received and the names of individuals who refuse to provide such statements. A long-term resident whose U.S. residency is terminated is required to attach a similar statement to his or her U.S. income tax return for the year of such termination. An individual's failure to provide the required statement results in the imposition of a penalty for each year the failure continues equal to the greater of (1) 5 percent of the individual's expatriation tax liability for such year, or (2) $1,000.

The State Department is required to provide the Secretary of the Treasury with a copy of each certificate of loss of nationality approved by the State Department. Similarly, the agency administering the immigration laws is required to provide the Secretary of the Treasury with the name of each individual whose status as a lawful permanent resident has been revoked or has been determined to have been abandoned. Further, the Secretary of the Treasury is required to publish in the Federal Register the names of all former U.S. citizens with respect to whom it receives the required statements or whose names or certificates of loss of nationality it receives under the foregoing information-sharing provisions.

Immigration rules with respect to expatriates

Under U.S. immigration laws, any former U.S. citizen who officially renounces his or her U.S. citizenship and who is determined by the Attorney General to have renounced for the purpose of U.S. tax avoidance is ineligible to receive a U.S. visa and will be denied entry into the United States. This provision was included as an amendment (the "Reed amendment") to immigration legislation that was enacted in 1996.

Description of Proposal

In general

The proposal generally subjects certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who terminate their U.S. residence to tax on the net unrealized gain in their property as if such property were sold for fair market value on the day before the expatriation or residency termination. Gain from the deemed sale is taken into account at that time without regard to other Code provisions; any loss from the deemed sale generally would be taken into account to the extent otherwise provided in the Code. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom relinquish citizenship or terminate residency). The $600,000 amount is increased by a cost of living adjustment factor for calendar years after 2003.

Individuals covered

Under the proposal, the mark-to-market tax applies to U.S. citizens who relinquish citizenship and long-term residents who terminate U.S. residency. An individual is a long-term resident if he or she was a lawful permanent resident for at least eight out of the 15 taxable years ending with the year in which the termination of residency occurs. An individual is considered to terminate long-term residency when either the individual ceases to be a lawful permanent resident (i.e., loses his or her green card status), or the individual is treated as a resident of another country under a tax treaty and the individual does not waive the benefits of the treaty.

Exceptions from the mark-to-market tax are provided in two situations. The first exception applies to an individual who was born with citizenship both in the United States and in another country; provided that (1) as of the expatriation date the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual was not a resident of the United States for the five taxable years ending with the year of expatriation. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18 and a half, provided that the individual was a resident of the United States for no more than five taxable years before such relinquishment.

Election to be treated as a U.S. citizen

Under the proposal, an individual is permitted to make an irrevocable election to continue to be taxed as a U.S. citizen with respect to all property that otherwise is covered by the expatriation tax. This election is an "all or nothing" election; an individual is not permitted to elect this treatment for some property but not for other property. The election, if made, would apply to all property that would be subject to the expatriation tax and to any property the basis of which is determined by reference to such property. Under this election, the individual would continue to pay U.S. income taxes at the rates applicable to U.S. citizens following expatriation on any income generated by the property and on any gain realized on the disposition of the property. In addition, the property would continue to be subject to U.S. gift, estate, and generation-skipping transfer taxes. In order to make this election, the taxpayer would be required to waive any treaty rights that would preclude the collection of the tax.

The individual also would be required to provide security to ensure payment of the tax under this election in such form, manner, and amount as the Secretary of the Treasury requires. The amount of mark-to-market tax that would have been owed but for this election (including any interest, penalties, and certain other items) shall be a lien in favor of the United States on all U.S.-situs property owned by the individual. This lien shall arise on the expatriation date and shall continue until the tax liability is satisfied, the tax liability has become unenforceable by reason of lapse of time, or the Secretary is satisfied that no further tax liability may arise by reason of this provision. The rules of section 6324A(d)(1), (3), and (4) (relating to liens arising in connection with the deferral of estate tax under section 6166) apply to liens arising under this provision.

Date of relinquishment of citizenship

Under the proposal, an individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates: (1) the date that the individual renounces U.S. nationality before a diplomatic or consular officer of the United States (provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (2) the date that the individual furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act (again, provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (3) the date that the State Department issues a certificate of loss of nationality; or (4) the date that a U.S. court cancels a naturalized citizen's certificate of naturalization.

Deemed sale of property upon expatriation or residency termination

The deemed sale rule of the proposal generally applies to all property interests held by the individual on the date of relinquishment of citizenship or termination of residency. Special rules apply in the case of trust interests, as described below. U.S. real property interests, which remain subject to U.S. tax in the hands of nonresident noncitizens, generally are excepted from the proposal. Regulatory authority is granted to the Treasury to except other types of property from the proposal.

Under the proposal, an individual who is subject to the mark-to-market tax is required to pay a tentative tax equal to the amount of tax that would be due for a hypothetical short tax year ending on the date the individual relinquished citizenship or terminated residency. Thus, the tentative tax is based on all income, gain, deductions, loss, and credits of the individual for the year through such date, including amounts realized from the deemed sale of property. The tentative tax is due on the 90th day after the date of relinquishment of citizenship or termination of residency.

Retirement plans and similar arrangements

Subject to certain exceptions, the provision applies to all property interests held by the individual at the time of relinquishment of citizenship or termination of residency. Accordingly, such property includes an interest in an employer-sponsored retirement plan or deferred compensation arrangement as well as an interest in an individual retirement account or annuity (i.e., an IRA).[9] However, the provision contains a special rule for an interest in a "qualified retirement plan." For purposes of the provision, a "qualified retirement plan" includes an employer-sponsored qualified plan (sec. 401(a)), a qualified annuity (sec. 403(a)), a tax-sheltered annuity (sec. 403(b)), an eligible deferred compensation plan of a governmental employer (sec. 457(b)), or an IRA (sec. 408). The special retirement plan rule applies also, to the extent provided in regulations, to any foreign plan or similar retirement arrangement or program. An interest in a trust that is part of a qualified retirement plan or other arrangement that is subject to the special retirement plan rule is not subject to the rules for interests in trusts (discussed below).

[9] Application of the provision is not limited to an interest that meets the definition of property under section 83 (relating to property transferred in connection with the performance of services).

Under the special rule, an amount equal to the present value of the individual's vested, accrued benefit under a qualified retirement plan is treated as having been received by the individual as a distribution under the plan on the day before the individual's relinquishment of citizenship or termination of residency. It is not intended that the plan would be deemed to have made a distribution for purposes of the tax-favored status of the plan, such as whether a plan may permit distributions before a participant has severed employment. In the case of any later distribution to the individual from the plan, the amount otherwise includible in the individual's income as a result of the distribution is reduced to reflect the amount previously included in income under the special retirement plan rule. The amount of the reduction applied to a distribution is the excess of: (1) the amount included in income under the special retirement plan rule over (2) the total reductions applied to any prior distributions. However, under the provision, the retirement plan, and any person acting on the plan's behalf, will treat any later distribution in the same manner as the distribution would be treated without regard to the special retirement plan rule.

It is expected that the Treasury Department will provide guidance for determining the present value of an individual's vested, accrued benefit under a qualified retirement plan, such as the individual's account balance in the case of a defined contribution plan or an IRA, or present value determined under the qualified joint and survivor annuity rules applicable to a defined benefit plan (sec. 417(e)).

Deferral of payment of tax

Under the proposal, an individual is permitted to elect to defer payment of the mark-to-market tax imposed on the deemed sale of the property. Interest is charged for the period the tax is deferred at a rate two percentage points higher than the rate normally applicable to individual underpayments. Under this election, the mark-to-market tax attributable to a particular property is due when the property is disposed of (or, if the property is disposed of in whole or in part in a nonrecognition transaction, at such other time as the Secretary may prescribe). The mark-to-market tax attributable to a particular property is an amount which bears the same ratio to the total mark-to-market tax for the year as the gain taken into account with respect to such property bears to the total gain taken into account under these rules for the year. The deferral of the mark-to-market tax may not be extended beyond the individual's death.

In order to elect deferral of the mark-to-market tax, the individual is required to provide adequate security to the Treasury to ensure that the deferred tax and interest will be paid. Other security mechanisms are permitted provided that the individual establishes to the satisfaction of the Secretary that the security is adequate. In the event that the security provided with respect to a particular property subsequently becomes inadequate and the individual fails to correct the situation, the deferred tax and the interest with respect to such property will become due. As a further condition to making the election, the individual is required to consent to the waiver of any treaty rights that would preclude the collection of the tax.

The deferred amount (including any interest, penalties, and certain other items) shall be a lien in favor of the United States on all U.S.-situs property owned by the individual. This lien shall arise on the expatriation date and shall continue until the tax liability is satisfied, the tax liability has become unenforceable by reason of lapse of time, or the Secretary is satisfied that no

further tax liability may arise by reason of this provision. The rules of section 6324A(d)(1), (3), and (4) (relating to liens arising in connection with the deferral of estate tax under section 6166) apply to liens arising under this provision.

Interests in trusts

Under the proposal, detailed rules apply to trust interests held by an individual at the time of relinquishment of citizenship or termination of residency. The treatment of trust interests depends on whether the trust is a qualified trust. A trust is a qualified trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.

Constructive ownership rules apply to a trust beneficiary that is a corporation, partnership, trust, or estate. In such cases, the shareholders, partners, or beneficiaries of the entity are deemed to be the direct beneficiaries of the trust for purposes of applying these provisions. In addition, an individual who holds (or who is treated as holding) a trust instrument at the time of relinquishment of citizenship or termination of residency is required to disclose on his or her tax return the methodology used to determine his or her interest in the trust, and whether such individual knows (or has reason to know) that any other beneficiary of the trust uses a different method.

Nonqualified trusts.–If an individual holds an interest in a trust that is not a qualified trust, a special rule applies for purposes of determining the amount of the mark-to-market tax due with respect to such trust interest. The individual's interest in the trust is treated as a separate trust consisting of the trust assets allocable to such interest. Such separate trust is treated as having sold its net assets as of the date of relinquishment of citizenship or termination of residency and having distributed the assets to the individual, who then is treated as having recontributed the assets to the trust. The individual is subject to the mark-to-market tax with respect to any net income or gain arising from the deemed distribution from the trust.

The election to defer payment is available for the mark-to-market tax attributable to a nonqualified trust interest. Interest is charged for the period the tax is deferred at a rate two percentage points higher than the rate normally applicable to individual underpayments. A beneficiary's interest in a nonqualified trust is determined under all the facts and circumstances, including the trust instrument, letters of wishes, and historical patterns of trust distributions.

Qualified trusts.–If an individual has an interest in a qualified trust, the amount of unrealized gain allocable to the individual's trust interest is calculated at the time of expatriation or residency termination. In determining this amount, all contingencies and discretionary interests are assumed to be resolved in the individual's favor (i.e., the individual is allocated the maximum amount that he or she could receive). The mark-to-market tax imposed on such gains is collected when the individual receives distributions from the trust, or if earlier, upon the individual's death. Interest is charged for the period the tax is deferred at a rate two percentage points higher than the rate normally applicable to individual underpayments.

If an individual has an interest in a qualified trust, the individual is subject to the mark-to-market tax upon the receipt of distributions from the trust. These distributions also may be

subject to other U.S. income taxes. If a distribution from a qualified trust is made after the individual relinquishes citizenship or terminates residency, the mark-to-market tax is imposed in an amount equal to the amount of the distribution multiplied by the highest tax rate generally applicable to trusts and estates, but in no event will the tax imposed exceed the deferred tax amount with respect to the trust interest. For this purpose, the deferred tax amount is equal to (1) the tax calculated with respect to the unrealized gain allocable to the trust interest at the time of expatriation or residency termination, (2) increased by interest thereon, and (3) reduced by any mark-to-market tax imposed on prior trust distributions to the individual.

If any individual's interest in a trust is vested as of the expatriation date (e.g., if the individual's interest in the trust is non-contingent and non-discretionary), the gain allocable to the individual's trust interest is determined based on the trust assets allocable to his or her trust interest. If the individual's interest in the trust is not vested as of the expatriation date (e.g., if the individual's trust interest is a contingent or discretionary interest), the gain allocable to his or her trust interest is determined based on all of the trust assets that could be allocable to his or her trust interest, determined by resolving all contingencies and discretionary powers in the individual's favor. In the case where more than one trust beneficiary is subject to the expatriation tax with respect to trust interests that are not vested, the rules are intended to apply so that the same unrealized gain with respect to assets in the trust is not taxed to both individuals.

Mark-to-market taxes become due if the trust ceases to be a qualified trust, the individual disposes of his or her qualified trust interest, or the individual dies. In such cases, the amount of mark-to-market tax equals the lesser of (1) the tax calculated under the rules for nonqualified trust interests as of the date of the triggering event, or (2) the deferred tax amount with respect to the trust interest as of that date.

The tax that is imposed on distributions from a qualified trust generally is deducted and withheld by the trustees. If the individual does not agree to waive treaty rights that would preclude collection of the tax, the tax with respect to such distributions is imposed on the trust, the trustee is personally liable for the tax, and any other beneficiary has a right of contribution against such individual with respect to the tax. Similar rules apply when the qualified trust interest is disposed of, the trust ceases to be a qualified trust, or the individual dies.

Coordination with present-law alternative tax regime

The proposal provides a coordination rule with the present-law alternative tax regime. Under the proposal, the expatriation income tax rules under section 877, and the expatriation estate and gift tax rules under sections 2107 and 2501(a)(3) (described above), do not apply to a former citizen or former long-term resident whose expatriation or residency termination occurs on or after February 5, 2003.

Treatment of gifts and inheritances from a former citizen or former long-term resident

Under the proposal, the exclusion from income provided in section 102 (relating to exclusions from income for the value of property acquired by gift or inheritance) does not apply to the value of any property received by gift or inheritance from a former citizen or former long-term resident (i.e., an individual who relinquished U.S. citizenship or terminated U.S. residency),

subject to the exceptions described above relating to certain dual citizens and minors. Accordingly, a U.S. taxpayer who receives a gift or inheritance from such an individual is required to include the value of such gift or inheritance in gross income and is subject to U.S. tax on such amount. Having included the value of the property in income, the recipient would then take a basis in the property equal to that value. The tax does not apply to property that is shown on a timely filed gift tax return and that is a taxable gift by the former citizen or former long-term resident, or property that is shown on a timely filed estate tax return and included in the gross U.S. estate of the former citizen or former long-term resident (regardless of whether the tax liability shown on such a return is reduced by credits, deductions, or exclusions available under the estate and gift tax rules). In addition, the tax does not apply to property in cases in which no estate or gift tax return is required to be filed, where no such return would have been required to be filed if the former citizen or former long-term resident had not relinquished citizenship or terminated residency, as the case may be. Applicable gifts or bequests that are made in trust are treated as made to the beneficiaries of the trust in proportion to their respective interests in the trust.

Information reporting

The proposal provides that certain information reporting requirements under present law (sec. 6039G) applicable to former citizens and former long-term residents also apply for purposes of the proposal.

Immigration rules

The proposal amends the immigration rules that deny tax-motivated expatriates reentry into the United States by removing the requirement that the expatriation be tax-motivated, and instead denies former citizens reentry into the United States if the individual is determined not to be in compliance with his or her tax obligations under the proposal's expatriation tax provisions (regardless of the subjective motive for expatriating). For this purpose, the proposal permits the IRS to disclose certain items of return information of an individual, upon written request of the Attorney General or his delegate, as is necessary for making a determination under section 212(a)(10)(E) of the Immigration and Nationality Act. Specifically, the proposal would permit the IRS to disclose to the agency administering section 212(a)(10)(E) whether such taxpayer is in compliance with section 877A and identify the items of noncompliance. Recordkeeping requirements, safeguards, and civil and criminal penalties for unauthorized disclosure or inspection would apply to return information disclosed under this provision.

Effective Date

The proposal generally is effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after February 5, 2003. The provisions of the proposal relating to gifts and inheritances are effective for gifts and inheritances received from former citizens and former long-term residents on or after February 5, 2003, whose expatriation or residency termination occurs on or after such date. The provisions of the proposal relating to former citizens under U.S. immigration laws are effective on or after the date of enactment.

JOINT COMMITTEE ON TAXATION
February 3, 2003
JCX-3-03

ESTIMATED REVENUE EFFECTS OF
THE "ARMED FORCES TAX FAIRNESS ACT OF 2003,"
SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON FEBRUARY 5, 2003

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
I. Improving Tax Equity for Military Personnel														
A. Exclusion of Gain on Sale of a Principal Residence by a Member of the Uniformed Services or the Foreign Service (distance of 50 miles; extended stay of 90 days; maximum suspension of 10 years)	soea 5/6/97	-66	-14	-14	-15	-15	-16	-16	-17	-18	-18	-19	-139	-227
B. Exclusion from Gross Income of Certain Death Gratuity Payments	doa 9/10/01	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-6	-10
C. Exclusion for Amounts Received under Department of Defense Homeowners Assistance Program	pma DOE	[1]	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	-11	-22
D. Expansion of Combat Zone Filing Rules to Contingency Operations	[2]	-9	[1]	[1]	[1]	[1]	-1	-1	-1	-1	-1	-1	-11	-14
E. Modification of Membership Requirement for Exemption from Tax for Certain Veterans' Organizations	tyba DOE	-1	-1	-1	-1	-2	-2	-2	-2	-2	-2	-2	-8	-17
F. Clarification of Treatment of Certain Dependent Care Assistance Programs Provided to Members of the Uniformed Services of the United States	tyba 12/31/02	No Revenue Effect												
G. Treatment of Service Academy Appointments as Scholarships for Purposes of Qualified Tuition Programs and Coverdell Education Savings Accounts	tyba 12/31/02	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-1	-2
H. Suspension of Tax-Exempt Status of Designated Terrorist Organizations	DOE	Negligible Revenue Effect												
I. Above-the-Line Deduction for Overnight Travel Expenses of National Guard and Reserve Members Traveling More Than 100 Miles from Home	apoii tyba 12/31/02	-15	-75	-77	-78	-80	-82	-84	-87	-89	-91	-93	-407	-851
Total of Improving Tax Equity for Military Personnel		**-92**	**-93**	**-95**	**-97**	**-100**	**-104**	**-106**	**-110**	**-113**	**-115**	**-118**	**-583**	**-1,143**
II. Revenue Provisions														
A. Extension of IRS User Fees (through 9/30/13) [3]	rma DOE	---	33	34	35	36	38	39	41	42	44	45	176	386
B. Authorize IRS to Enter into Installment Agreements that Provide for Partial Payment	laeio/a DOE	11	30	14	5	[4]	[4]	[4]	[4]	[4]	[4]	[4]	61	63

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
C. Impose Mark-to-Market on Individuals Who Expatriate	[5]	3	98	84	80	74	71	67	61	57	54	51	410	700
Total of Revenue Provisions..		**14**	**161**	**132**	**120**	**110**	**109**	**106**	**102**	**99**	**98**	**96**	**647**	**1,149**
NET TOTAL		**-78**	**68**	**37**	**23**	**10**	**5**	**0**	**-8**	**-14**	**-17**	**-22**	**64**	**6**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:
apoii = amounts paid or incurred in
doa = deaths occurring after
DOE = date of enactment
iaeio/a = installment agreements entered into on or after
pma = payments made after
rma = requests made after
tyba = taxable years beginning after
soea = sales or exchanges after

[1] Loss of less than $500,000.
[2] The provision applies to any period for performing an act that has not expired before the date of enactment.
[3] Estimate provided by Congressional Budget Office.
[4] Gain of less than $500,000.
[5] Generally effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after February 5, 2003.

DESCRIPTION OF THE "CARE ACT OF 2003"

Scheduled for a Markup
By the
SENATE COMMITTEE ON FINANCE
on February 5, 2003

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

February 3, 2003
JCX-04-03

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on February 5, 2003, of the "CARE Act of 2003." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "CARE Act of 2003."

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "CARE Act of 2003"* (JCX-04-03), February 3, 2003.

I. CHARITABLE GIVING INCENTIVES

A. Charitable Deduction for Nonitemizers

Present Law

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to a charity described in section 501(c)(3),[2] to certain veterans' organizations, fraternal societies, and cemetery companies,[3] or to a Federal, State, or local governmental entity for exclusively public purposes.[4] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[5]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[6]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.[7] In addition, present law requires that any charity that

[2] All section references are to the Internal Revenue Code of 1986, unless otherwise indicated.

[3] Secs. 170(c)(3)-(5).

[4] Sec. 170(c)(1).

[5] Secs. 170(b) and (e).

[6] Sec. 170(a). The Economic Recovery Tax Act of 1981 adopted a temporary provision that permitted individual taxpayers who did not itemize income tax deductions to claim a deduction from gross income for a specified percentage of their charitable contributions. The maximum deduction was $25 for 1982 and 1983, $75 for 1984, 50 percent of the amount of the contribution for 1985, and 100 percent of the amount of the contribution for 1986. The nonitemizer deduction terminated for contributions made after 1986.

[7] Sec. 170(f)(8).

receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services is deductible as a charitable contribution.[8]

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

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

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is indexed annually for inflation. The threshold amount for 2003 is $139,500 ($69,750 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by three percent of adjusted gross income over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. Beginning in 2006, the overall limitation on itemized deductions phases-out for all taxpayers. The overall limitation on itemized deductions is reduced by one-third in taxable years beginning in 2006 and 2007, and by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation on itemized deductions is eliminated for taxable years beginning after December 31, 2009; however, this elimination of the limitation sunsets on December 31, 2010.

Description of Proposal

In the case of an individual taxpayer who does not itemize deductions, the proposal allows a "direct charitable deduction" from adjusted gross income for charitable contributions paid in cash during the taxable year. This deduction is allowed in addition to the standard deduction. The deduction is available only for that portion of contributions actually made during the year that in the aggregate exceed $250 ($500 in the case of a joint return). The maximum deduction is $250 ($500 in the case of a joint return). Contributions that are below the minimum amount or that exceed the maximum deduction may not be carried over for purposes of a subsequent taxable year's calculation of the direct charitable deduction. Under the proposal, an

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[8] Sec. 6115.

individual is not entitled to a charitable deduction for the first $250 of cash contributions made during the tax year, is entitled to a deduction on a dollar-for-dollar basis for contributions of $251 to $500 (e.g., a $1 contribution deduction in the case of $251 of contributions, and a $250 deduction in the case of $500 of contributions), and is not entitled to a deduction for contributions exceeding $500.

The proposal does not alter present-law rules regarding the carryover of contributions to or from a taxable year, including a taxable year in which the taxpayer elects the standard deduction. The direct charitable deduction generally is subject to the tax rules normally governing charitable contribution deductions, such as the substantiation requirements. The deduction is allowed in computing alternative minimum taxable income.

The proposal requires the Secretary of the Treasury to complete a study by December 31, 2004, of the effect of the proposal on increased charitable giving, and of taxpayer compliance, for example, by comparing compliance by taxpayers who itemize their charitable contributions with compliance by those who claim the direct charitable deduction. The Secretary shall report on the study to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives.

Effective Date

The direct charitable deduction is effective for taxable years beginning after December 31, 2002, and before January 1, 2005. The Treasury study is required by December 31, 2004.

B. Tax-Free Distributions From Individual Retirement Arrangements for Charitable Purposes

Present Law

In general

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

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to a charity described in section 501(c)(3),[9] to certain veterans' organizations, fraternal societies, and cemetery companies,[10] or to a Federal, State, or local governmental entity for exclusively public purposes.[11] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[12]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[13]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate that the payment exceeds the fair market value of the benefit received

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[9] All section references are to the Internal Revenue Code of 1986, unless otherwise indicated.

[10] Secs. 170(c)(3)-(5).

[11] Sec. 170(c)(1).

[12] Secs. 170(b) and (e).

[13] Sec. 170(a). The Economic Recovery Tax Act of 1981 adopted a temporary provision that permitted individual taxpayers who did not itemize income tax deductions to claim a deduction from gross income for a specified percentage of their charitable contributions. The maximum deduction was $25 for 1982 and 1983, $75 for 1984, 50 percent of the amount of the contribution for 1985, and 100 percent of the amount of the contribution for 1986. The nonitemizer deduction terminated for contributions made after 1986.

from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.[14] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services is deductible as a charitable contribution.[15]

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

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

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is indexed annually for inflation. The threshold amount for 2003 is $139,500 ($69,750 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by three percent of adjusted gross income over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. Beginning in 2006, the overall limitation on itemized deductions phases-out for all taxpayers. The overall limitation on itemized deductions is reduced by one-third in taxable years beginning in 2006 and 2007, and by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation on itemized deductions is eliminated for taxable years beginning after December 31, 2009; however, this elimination of the limitation sunsets on December 31, 2010.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (e.g., a remainder) while also either

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[14] Sec. 170(f)(8).

[15] Sec. 6115.

retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[16] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[17] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Individuals also may make nondeductible contributions to a Roth IRA. Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59-1/2 are subject to an additional 10-percent early withdrawal tax, unless an exception applies.

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

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[18] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

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[16] Secs. 170(f), 2055(e)(2), and 2522(c)(2).

[17] Sec. 170(f)(2).

[18] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

Split-interest trust filing requirements

Split-interest trusts, including charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, are required to file an annual information return[19] (Form 1041A). Trusts that are not split-interest trusts but that claim a charitable deduction for amounts permanently set aside for a charitable purpose[20] also are required to file Form 1041A. The returns are required to be made publicly available.[21] A trust that is required to distribute all trust net income currently to trust beneficiaries in a taxable year is exempt from this return requirement for such taxable year. A failure to file the required return may result in a penalty on the trust of $10 a day for as long as the failure continues, up to a maximum of $5,000 per return.

In addition, split-interest trusts are required to file annually Form 5227.[22] Form 5227 requires disclosure of information regarding a trust's noncharitable beneficiaries. The penalty for failure to file this return is calculated based on the amount of tax owed. A split-interest trust generally is not subject to tax and therefore, in general, a penalty may not be imposed for the failure to file Form 5227. Form 5227 is not required to be made publicly available.

Description of Proposal

Qualified charitable distributions from IRAs

The proposal provides an exclusion from gross income for otherwise taxable IRA distributions from a traditional or a Roth IRA in the case of qualified charitable distributions. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The present-law rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions.

A qualified charitable distribution is defined as any distribution from an IRA that is made directly by the IRA trustee either to (1) an organization to which deductible contributions can be made (a "direct distribution") or (2) a "split-interest entity." A split-interest entity means a charitable remainder annuity trust or charitable remainder unitrust (together referred to as a "charitable remainder trust"), a pooled income fund, or a charitable gift annuity. Direct distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70-1/2. Distributions to a split interest entity are eligible for the exclusion only if made on or after the date the IRA owner attains age 59-1/2. In the case of split-interest distributions, no person may hold an income interest in the amounts in the split-interest entity attributable to the charitable distribution other than the IRA owner, his or her spouse, or a charitable organization.

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[19] Sec. 6034. This requirement applies to all split-interest trusts described in section 4947(a)(2).

[20] Sec. 642(c).

[21] Sec. 6104(b).

[22] Sec. 6011; Treas. Reg. sec. 53.6011-1(d).

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

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

Special rules apply for distributions to split-interest entities. For distributions to charitable remainder trusts, the proposal provides that subsequent distributions from the charitable remainder trust are treated as ordinary income in the hands of the beneficiary, notwithstanding how such amounts normally are treated under section 664(b). In addition, for a charitable remainder trust to be eligible to receive qualified charitable distributions, the charitable remainder trust has to be funded exclusively by such distributions. For example, an IRA owner may not make qualified charitable distributions to an existing charitable remainder trust any part of which was funded with assets that were not qualified charitable distributions.

Under the proposal, a pooled income fund is eligible to receive qualified charitable distributions only if the fund accounts separately for amounts attributable to such distributions. In addition, all distributions from the pooled income fund that are attributable to qualified charitable distributions are treated as ordinary income to the beneficiary. Qualified charitable distributions to a pooled income fund are not includible in the fund's gross income.

In determining the amount includible in gross income by reason of a payment from a charitable gift annuity purchased with a qualified charitable distribution from an IRA, the portion of the distribution from the IRA used to purchase the annuity is not an investment in the annuity contract.

Any amount excluded from gross income by reason of the proposal is not taken into account in determining the deduction for charitable contributions under section 170.

<u>Qualified charitable distribution examples</u>

The following examples illustrate the determination of the portion of an IRA distribution that is a qualified charitable distribution and the application of the special rules for a qualified

charitable distribution to a split-interest entity. In each example, it is assumed that the requirements for qualified charitable distribution treatment are otherwise met (e.g., the applicable age requirement and the requirement that contributions are otherwise deductible) and that no other IRA distributions occur during the year.

Example 1. Individual A has a traditional IRA with a balance of $100,000, consisting solely of deductible contributions and earnings. Individual A has no other IRA. The entire IRA balance is distributed in a direct distribution to a charitable organization. Under present law, the entire distribution of $100,000 would be includible in Individual A's income. Accordingly, under the proposal, the entire distribution of $100,000 is a qualified charitable distribution. As a result, no amount is included in Individual A's income as a result of the distribution and the distribution is not taken into account in determining the amount of Individual A's charitable deduction for the year.

Example 2. The facts are the same as in Example 1, except that the entire IRA balance of $100,000 is distributed to a charitable remainder unitrust, which contains no other assets and which must be funded exclusively by qualified charitable distributions. Under the terms of the trust, Individual A is entitled to receive five percent of the value of the trust each year. As explained in Example l, the entire $100,000 distribution is a qualified charitable distribution, no amount is included in Individual A's income as a result of the distribution, and the distribution is not taken into account in determining the amount of Individual A's charitable deduction for the year. In addition, under a special rule in the proposal for charitable remainder trusts, any distribution from the charitable remainder unitrust to Individual A is includible in gross income as ordinary income, regardless of the character of the distribution under the usual rules for the taxation of distributions from such a trust.

Example 3. Individual B has a traditional IRA with a balance of $100,000, consisting of $20,000 of nondeductible contributions and $80,000 of deductible contributions and earnings. Individual B has no other IRA. In a direct distribution to a charitable organization, $80,000 is distributed from the IRA. Under present law, a portion of the distribution from the IRA would be treated as a nontaxable return of nondeductible contributions. The nontaxable portion of the distribution would be $16,000, determined by multiplying the amount of the distribution ($80,000) by the ratio of the nondeductible contributions to the account balance ($20,000/$100,000). Accordingly, under present law, $64,000 of the distribution ($80,000 minus $16,000) would be includible in Individual B's income.

Under the proposal, notwithstanding the present-law tax treatment of IRA distributions, the distribution is treated as consisting of income first, up to the total amount that would be includible in gross income (but for the proposal) if all amounts were distributed from all IRAs otherwise taken into account in determining the amount of IRA distributions. The total amount that would be includible in income if all amounts were distributed from the IRA is $80,000. Accordingly, under the proposal, the entire $80,000 distributed to the charitable organization is treated as includible in income (before application of the proposal) and is a qualified charitable distribution. As a result, no amount is included in Individual B's income as a result of the distribution and the distribution is not taken into account in determining the amount of Individual B's charitable deduction for the year. In addition, for purposes of determining the tax

treatment of other distributions from the IRA, $20,000 of the amount remaining in the IRA is treated as Individual B's nondeductible contributions.

Split-interest trust filing requirements

The proposal increases the penalty on split-interest trusts for failure to file a return and for failure to include any of the information required to be shown on such return and to show the correct information. The penalty is $20 for each day the failure continues up to $10,000 for any one return. In the case of a split-interest trust with gross income in excess of $250,000, the penalty is $100 for each day the failure continues up to a maximum of $50,000. In addition, if a person (meaning any officer, director, trustee, employee, or other individual who is under a duty to file the return or include required information)[23] knowingly failed to file the return or include required information, then that person is personally liable for such a penalty, which would be imposed in addition to the penalty that is paid by the organization. Information regarding beneficiaries that are not charitable organizations as described in section 170(c) is exempt from the requirement to make information publicly available. In addition, the proposal repeals the present-law exception to the filing requirement for split-interest trusts that are required in a taxable year to distribute all net income currently to beneficiaries. Such exception remains available to trusts other than split-interest trusts that are otherwise subject to the filing requirement.

Effective Date

For direct distributions, the proposal is effective for distributions made after the date of enactment. For distributions to a split-interest entity, the proposal is effective for distributions made after December 31, 2003. The proposal relating to information returns of split-interest trusts is effective for returns for taxable years beginning after December 31, 2003.

[23] Sec. 6652(c)(4)(C).

C. Charitable Deduction for Contributions of Food Inventory

Present Law

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

However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis.[24] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of ongoing disputes between taxpayers and the IRS. In one case, the Tax Court held that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted.[25]

Description of Proposal

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

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[24] Sec. 170(e)(3). In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income. Sec. 170(b)(2).

[25] *Lucky Stores Inc. v. Commissioner,* 105 T.C. 420 (1995).

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

For purposes of calculating the enhanced deduction, taxpayers who do not account for inventories under section 471 and who are not required to capitalize indirect costs under section 263A are able to elect to treat the basis of the contributed food as being equal to 25 percent of the food's fair market value.[26]

The proposal changes the amount of the present-law enhanced deduction for eligible contributions of food inventory to the lesser of fair market value or twice the taxpayer's basis in the inventory. For example, a taxpayer who makes an eligible donation of food that has a fair market value of $10 and a basis of $4 could take a deduction of $8 (twice basis). If the taxpayer's basis was $6 instead of $4, then the deduction would be $10 (fair market value). By contrast, under present law, a C corporation's deduction in the first example would be $7 (fair market value less half the appreciation) and in the second example would be $8. (Under present law, taxpayers other than C corporations generally could take a deduction for a contribution of food inventory only for the $4 basis in either example.) Taxpayers that do not account for inventories under section 471 and who are not required to capitalize indirect costs under section 263A would be able to elect to treat the basis of the contributed food as being equal to 25 percent of the food's fair market value.

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

In addition, the proposal provides that the fair market value of donated apparently wholesome food that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market is determined without regard to such internal standards or lack of market and by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer at the time of the contribution or, if not so sold at such time, in the recent past.

Effective Date

The proposal is effective for contributions made after the date of enactment.

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[26] This includes, for example, taxpayers who are eligible for administrative relief under Revenue Procedures 2002-28 and 2001-10.

D. Charitable Deduction for Contributions of Book Inventory

Present Law

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

However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis.[27] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.

Description of Proposal

The proposal modifies the present-law enhanced deduction for C corporations so that it is equal to the lesser of fair market value or twice the taxpayer's basis in the case of qualified book contributions. The proposal provides that the fair market value for this purpose is determined by reference to a bona fide published market price for the book. Under the proposal, a bona fide published market price of a book is a price of a book, determined using the same printing and same edition, published within seven years preceding the contribution, determined as a result of an arm's length transaction, and for which the book was customarily sold. For example, a publisher's listed retail price for a book would not meet the standard if the publisher could not demonstrate to the satisfaction of the Secretary that the price was one at which the book was customarily sold and was the result of an arm's length transaction. If a publisher entered into a contract with a local school district to sell newly published textbooks six years prior to making a qualified book contribution of such textbooks, the publisher could use as a bona fide published market price, the price at which such books regularly were sold to the school district under the contract. By contrast, if a publisher listed in a catalogue or elsewhere a "suggested retail price," but books were not in fact customarily sold at such price, the publisher could not use the "suggested retail price" to determine the fair market value of the book for purposes of the enhanced deduction. Thus, in general, a bona fide published market price must be independently verifiable by reference to actual sales within the seven-year period preceding the contribution, and not to a publisher's own price list.

As an illustration of the mechanics of calculating the enhanced deduction under the proposal, a C corporation that made a qualified book contribution with a bona fide published market price of $10 and a basis of $4 could take a deduction of $8 (twice basis). If the taxpayer's basis is $6 instead of $4, then the deduction is $10. Also, in such latter case, if the

[27] Sec. 170(e)(3).

book's bona fide market published market price was $5 at the time of the contribution but was $10 five years before the contribution, then the deduction is $10.

A qualified book contribution means a charitable contribution of books to: (1) an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on; (2) a public library; or (3) an organization described in section 501(c)(3) (except for private nonoperating foundations), that is organized primarily to make books available to the general public at no cost or to operate a literacy program. The donee must: (1) use the property consistent with the donee's exempt purpose; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements and also that the books are suitable, in terms of currency, content, and quantity, for use in the donee's educational programs and that the donee will use the books in such educational programs.

Effective Date

The proposal is effective for contributions made after the date of enactment.

E. Expand Charitable Contribution Allowed for Scientific Property Used for Research and for Computer Technology and Equipment

Present Law

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the charitable deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.[28]

Under present law, a taxpayer's deduction for charitable contributions of scientific property used for research and for contributions of computer technology and equipment generally is limited to the taxpayer's basis (typically, cost) in the property. However, certain corporations may claim a deduction in excess of basis for a "qualified research contribution" or a "qualified computer contribution."[29] This enhanced deduction is equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value minus basis) or (2) two times basis. The enhanced deduction for qualified computer contributions expires for any contribution made during any taxable year beginning after December 31, 2003.

A qualified research contribution means a charitable contribution of inventory that is tangible personal property. The contribution must be to a qualified educational or scientific organization and be made not later than two years after construction of the property is substantially completed. The original use of the property must be by the donee, and be used substantially for research or experimentation, or for research training, in the U.S. in the physical or biological sciences. The property must be scientific equipment or apparatus, constructed by the taxpayer, and may not be transferred by the donee in exchange for money, other property, or services. The donee must provide the taxpayer with a written statement representing that it will use the property in accordance with the conditions for the deduction. For purposes of the enhanced deduction, property is considered constructed by the taxpayer only if the cost of the parts used in the construction of the property (other than parts manufactured by the taxpayer or a related person) do not exceed 50 percent of the taxpayer's basis in the property.

A qualified computer contribution means a charitable contribution of any computer technology or equipment, which meets standards of functionality and suitability as established by the Secretary of the Treasury. The contribution must be to certain educational organizations or public libraries and made not later than three years after the taxpayer acquired the property or, if the taxpayer constructed the property, not later than the date construction of the property is

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[28] Sec. 170(e)(1).

[29] Secs. 170(e)(4) and 170(e)(6).

substantially completed.[30] The original use of the property must be by the donor or the donee,[31] and in the case of the donee, must be used substantially for educational purposes related to the function or purpose of the donee. The property must fit productively into the donee's education plan. The donee may not transfer the property in exchange for money, other property, or services, except for shipping, installation, and transfer costs. To determine whether property is constructed by the taxpayer, the rules applicable to qualified research contributions apply. Contributions may be made to private foundations under certain conditions.[32]

Description of Proposal

Under the proposal, property assembled by the taxpayer, in addition to property constructed by the taxpayer, is eligible for either enhanced deduction.

The proposal extends the enhanced deduction for qualified computer contributions to contributions made before January 1, 2006.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

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[30] If the taxpayer constructed the property and reacquired such property, the contribution must be within three years of the date the original construction was substantially completed. Sec. 170(e)(6)(D)(i).

[31] This requirement does not apply if the property was reacquired by the manufacturer and contributed. Sec. 170(e)(6)(D)(ii).

[32] Sec. 170(e)(6)(C).

F. Encourage Contributions of Capital Gain Real Property Made for Conservation Purposes

Present Law

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[33]

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks. For individuals, the amount deductible is a percentage of the taxpayer's contribution base, which is the taxpayer's adjusted gross income computed without regard to any net operating loss carryback. The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. Cash contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50 percent of the taxpayer's contribution base. Cash contributions to private foundations and certain other organizations generally may be deducted up to 30 percent of the taxpayer's contribution base.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity while also either retaining an interest in that property or transferring an interest in that property to a noncharity for less than full and adequate consideration. Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property, and qualified conservation contributions.

Capital gain property

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

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

property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions. Contributions of capital gain property that exceed the percentage limitation may be carried forward for five years.

Qualified conservation contributions

Qualified conservation contributions are not subject to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

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

Description of Proposal

In general

Under the proposal, the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Thus, individuals may include the fair market value of any qualified conservation contribution of capital gain property in determining the amount of the charitable contributions subject to the 50-percent contribution base limitation.

Individuals are allowed to carryover any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years. The 50-percent contribution base limitation applies first to contributions other than qualified conservation contributions and then to qualified conservation contributions. For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions of $60. The individual is allowed a deduction of $50 in the current taxable year for the other contributions (50 percent of the $100 contribution base) and is allowed to carryover the excess $10 for up to 5 years. No current deduction is allowed for the

qualified conservation contribution but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and ranchers

In the case of an eligible farmer or rancher, a qualified conservation contribution is allowable up to 100 percent of the taxpayer's contribution base (after taking into account other charitable contributions). This rule applies both to individuals and corporations. In addition, corporate (as well as non-corporate) eligible farmers and ranchers are allowed to carryover any excess qualified conservation contributions for up to 15 years. The 100-percent contribution base limitation applies first to contributions other than qualified conservation contributions (to the extent allowable under other percentage limitations) and then to qualified conservation contributions. For example, assume an individual farmer or rancher with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions of $60. The individual is allowed a deduction of $50 in the current taxable year for the other contributions (50 percent of the $100 contribution base) and is allowed to carryover the excess $10 for up to 5 years. The individual also is allowed a deduction of $50 in the current taxable year for the qualified charitable contribution (the amount of the remaining contribution base). The remaining $30 qualified conservation contribution may be carried forward for up to 15 years.

For this purpose, an eligible farmer or rancher means a taxpayer (other than a publicly traded C corporation) whose gross income from the trade of business of farming is at least 51 percent of the taxpayer's gross income for the taxable year.

Effective Date

The proposal is effective for contributions made after the date of enactment.

G. Exclusion of 25 Percent of Capital Gain for Certain Sales Made for Qualifying Conservation Purposes

Present Law

Sales of capital gain property

Gain from the sale or exchange of land held more than one year generally is treated as long-term capital gain. Generally, the net capital gain of an individual (i.e., long-term capital gain less short-term capital loss) is subject to a maximum tax rate of 20 percent.

Charitable contributions of capital gain property for conservation purposes

Special rules apply to charitable contributions of qualified conservation contributions. Qualified conservation contributions are not subject to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Charitable contributions of interests that constitute the taxpayer's entire interest in the property are not regarded as qualified real property interests within the meaning of section 170(h),[34] but instead are subject to the general rules applicable to charitable contributions of entire interests of the taxpayer. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Treasury regulations provide that a deduction for a qualified conservation contribution is allowed only if the donor prohibits in the instrument of conveyance the donee from subsequently transferring the qualified real property interest, whether or not for consideration, unless the donee organization, as a condition of the subsequent transfer, requires that the conservation purpose which the contribution was originally intended to advance continues to be carried out.[35] Moreover, subsequent transfers of such interests are restricted to organizations that are qualified conservation organizations.[36]

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[34] Ltr. Rul. 8626029.

[35] Treas. Reg. sec. 1.170A-14(c)(2).

[36] *Id.*

Description of Proposal

In general

The proposal provides a 25-percent exclusion from gross income of long-term capital gain from the qualifying sale or exchange of land, or an interest in land or water rights, provided that the land or interest in land or water rights constitutes an interest in real property that has been held by the taxpayer or the taxpayer's family at all times during the five years preceding the date of sale. The qualifying sale must be made to a qualified organization that intends that the acquired property be used for qualified conservation purposes in perpetuity.[37]

Qualifying interests

The exclusion applies only to sales or exchanges of real property interests in land or water rights that constitute the entire interest of the taxpayer in such land or water rights, or that constitute qualified real property interests as defined in section 170(h), specifically: (1) the entire interest of the taxpayer other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use which may be made of the real property. Partial interests in property that are not the entire interest of the taxpayer or a qualified real property interest do not qualify for the exclusion. For example, a taxpayer who owns land and related mineral rights but who sells only the mineral rights is not eligible for the exclusion. However, a taxpayer who owns only mineral rights is eligible for the 25-percent exclusion if the taxpayer sells his or her entire interest in the mineral rights and satisfies the other requirements of the proposal.

Generally, an undivided interest that constitutes the taxpayer's entire interest in the property is eligible for the exclusion. A partial interest that constitutes the taxpayer's entire interest in the property, however, does not qualify for the exclusion if the property in which such partial interest exists was divided in an attempt to avoid the partial interest rules.

Under the proposal, the exclusion is available for long-term capital gain from certain sales or exchanges of stock in a C corporation if the qualified organization ultimately obtains a controlling stock interest (generally a stock interest that provides the qualified organization at least 90 percent of the total voting power and total value of the corporation's stock) and if at least 90 percent of the fair market value of the C corporation's assets at the time of the sale or exchange consists of land or water rights, or interests in land or water rights, that were held by the corporation at all times during the five years preceding the sale. Stock in a corporation will not qualify if at the time of the sale or exchange the fair market value of water rights and infrastructure relating to the delivery of water constitutes more than 50 percent of the fair market

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[37] The exclusion is mandatory if all of the requirements of the proposal are satisfied, and a taxpayer need not file an election to take advantage of the exclusion. A taxpayer who transfers qualifying property to a qualified organization may opt out of the 25-percent exclusion by choosing not to satisfy one or more of the proposal's requirements without having to file a formal election with the Secretary, such as by failing to obtain the requisite letter of intent from the qualified organization.

value of all of the corporation's assets. Only a stock interest held by the taxpayer or the taxpayer's family at all times during the five years preceding the sale qualifies for the 25-percent exclusion.

Qualifying gain

The exclusion applies only to long-term capital gain. Gain treated as ordinary income, such as under depreciation recapture provisions, is not eligible for the exclusion. Gain attributable to certain improvements, such as buildings or structures that do not further a qualified conservation purpose ("disqualified improvements"), also does not qualify for the exclusion.[38] The proposal provides that the maximum amount of gain that may be excluded by a shareholder in the case of a sale or exchange of a controlling stock interest is 25 percent of the shareholder's proportionate share of the C corporation's underlying gain attributable to qualifying land, water rights, or interests therein held by the C corporation.

Consistent with present law, the determination of gain or loss is to be calculated on an asset-by-asset basis whenever that is required for other purposes of the Code (such as for purposes of section 1245 or section 1250). In those cases where the Code does not otherwise require a separate determination of gain or loss for the disqualified improvement, the gain allocable to the disqualified improvement shall be determined by reference to the fair market value of the disqualified improvement relative to the fair market value of all assets for which a gain or loss determination is not otherwise required by the Code.[39]

For example, if a taxpayer sells a qualifying land interest with a fair market value of $100 and a basis of $30, that includes a building or structure that does not further a conservation purpose (a disqualified improvement) and that has a fair market value of $40, the taxpayer must determine the portion of the gain that is attributable to the eligible land and to the disqualified improvement. If determination of gain or loss on the sale of the improvement is required for other purposes of the Code, then the gain or loss determined for those purposes governs, and the taxpayer must determine his or her basis of the disqualified improvement (in this case, assumed to be zero), with the result that the $40 gain on the disqualified improvement is not eligible for the 25-percent exclusion and the gain of $30 on the land is eligible for the 25-percent exclusion. On the other hand, if the determination of gain or loss on the sale of the improvement is not required for other purposes of the Code, then the taxpayer shall allocate the aggregate gain of $70 attributable to the land and the disqualified improvement between the land and the improvement on the basis of their respective fair market values (i.e., 40 percent to the improvement and 60 percent to the land). Under this gain allocation rule, the $28 of gain

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[38] Soil and water conservation expenditures in the nature of those described in section 175, determined without regard to whether the taxpayer is engaged in a farming business and that the land be used for farming, generally shall be treated as furthering a qualified conservation purpose.

[39] The taxpayer shall be required to use this gain allocation rule unless the taxpayer has adequate records to substantiate the adjusted basis and fair market value to support a separate calculation.

allocable to the improvement is not eligible for the 25-percent exclusion, and the $42 of gain allocable to the land qualifies for the 25-percent exclusion.

Eligible sales

An eligible sale is a sale or exchange (excluding a transfer made by order of condemnation or eminent domain)[40] that may be made only to a qualified organization, defined as a Federal, State, or local government, or an agency or department thereof or a section 501(c)(3) organization that is organized and operated primarily to meet a qualified conservation purpose. In addition, to be an eligible sale, the organization acquiring the property interest must provide the taxpayer with a letter stating that the intent of such organization in acquiring the property is to further a qualified conservation purpose and that any subsequent transfer of the acquired interest will be to a qualified organization and made to protect the conservation purpose in perpetuity. A qualified conservation purpose is: (1) the preservation of land areas for outdoor recreation by, or the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; or (3) the preservation of open space (including farmland and forest land) where the preservation is for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy and will yield a significant public benefit.

Protection of conservation purposes

The proposal provides for the imposition of penalty excise taxes in appropriate cases where a qualified organization fails to take steps consistent with the protection of conservation purposes. If ownership or possession of the property is transferred by a qualified organization other than to another qualified organization, or a legal restriction contained in an instrument of conveyance that protects the qualified conservation purpose is removed, then: (1) a 20-percent excise tax applies to the proceeds or fair market value of the property; (2) any realized gain or income is subject to an additional excise tax imposed at the highest income tax rate applicable to C corporations; and (3) any otherwise applicable non-recognition provisions of the Code shall not apply to the transferor. The excise taxes shall apply to all cases involving the transfer of ownership or possession of the property to a transferee that is not a qualified organization unless the transferring qualified organization demonstrates to the satisfaction of the Secretary that qualified conservation purposes will be protected in perpetuity. In the case of a removal of a legal restriction contained in an instrument of conveyance, the qualified organization must demonstrate to the satisfaction of the Secretary that a later unexpected change in the conditions surrounding the property makes retaining the conservation restriction impossible or impractical and that any proceeds derived from the removal of the restriction will be used to further qualified conservation purposes.

In the case of a transfer by a qualified organization to another qualified organization, the transferee must provide the transferor at the time of the transfer a letter stating that the intent of the transferee is to further a qualified conservation purpose and that any subsequent transfer of

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[40] A sale or exchange made prior to the issuance of an order, but that is the result of a threat of condemnation or eminent domain, may qualify for the exclusion.

the acquired interest will be made to protect the conservation purpose in perpetuity, and the transferee becomes subject to the excise tax provisions for subsequent transfers.

The proposal provides that the Secretary may require such reporting as may be necessary or appropriate to further the purpose that any conservation use be in perpetuity.

Relationship with other provisions

In the case of an individual, the exclusion applies both for purposes of the regular tax and the alternative minimum tax. In the case of a corporation, the present-law alternative minimum tax provisions apply without modification.

If a taxpayer sells a real property interest to a qualified organization for less than the property's fair market value, the amount of any charitable contribution deduction is determined in accordance with the bargain sale rules,[41] and the taxpayer shall not fail to qualify for a contribution deduction under those rules solely because the taxpayer derives a tax benefit from the partial exclusion of long-term capital gain from the sale. For example, if a taxpayer sells qualifying land with a fair market value of $100 and an adjusted basis of $10 to a qualified organization for a sales price of $95 (or alternatively, for a sale price of $50), the taxpayer's basis of $10 shall be allocated between the sale and the contribution components of the transfer under the bargain sale rules, and the tax savings resulting from the 25-percent exclusion of long-term capital gain on the sale will not reduce the portion of the transfer treated as a charitable contribution under the bargain sale rules. The present-law requirements applicable to the charitable contribution component of the transfer, including, for example, the recordkeeping, substantiation, and appraisal provisions of Treasury Regulations section 1.170A-13, must be satisfied.

Effective Date

The proposal is effective for sales or exchanges occurring after the date of enactment.

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[41] Sec. 1011(b) and Treas. Reg. sec. 1.1011-2.

H. Cost Sharing Payments under the Partners for Fish and Wildlife Program

Present Law

Under present law, gross income does not include the excludable portion of payments made to taxpayers by federal and state governments for a share of the cost of improvements to property under certain conservation programs. These programs include payments received under (1) the rural clean water program authorized by section 208(j) of the Federal Water Pollution Control Act, (2) the rural abandoned mine program authorized by section 406 of the Surface Mining Control and Reclamation Act of 1977, (3) the water bank program authorized by the Water Bank Act, (4) the emergency conservation measures program authorized by title IV of the Agricultural Credit Act of 1978, (5) the agriculture conservation program authorized by the Soil Conservation and Domestic Allotment Act, (6) the great plains conservation program authorized by section 16 of the Soil Conservation and Domestic Policy Act, (7) the resource conservation and development program authorized by the Bankhead-Jones Farm Tenant Act and by the Soil Conservation and Domestic Allotment Act, (8) the forestry incentives program authorized by section 4 of the Cooperative Forestry Assistance Act of 1978, (9) any small watershed program administered by the Secretary of Agriculture which is determined by the Secretary of the Treasury or his delegate to be substantially similar to the type of programs described in items (1) through (8), and (10) any program of a State, possession of the United States, a political subdivision of any of the foregoing, or the District of Columbia under which payments are made to individuals primarily for the purpose of conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife.

Description of Proposal

The proposal expands the types of qualified cost-sharing payments to include payments under the Partners for Fish and Wildlife Program.

Effective Date

The proposal applies to payments received after the date of enactment.

I. Basis Adjustment to Stock of S Corporation Contributing Property

Present Law

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.[42] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[43]

Description of Proposal

The proposal provides that the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation will be equal to the shareholder's pro rata share of the adjusted basis of the contributed property.[44]

Thus, for example, assume an S corporation with one individual shareholder makes a charitable contribution of stock with a basis of $200 and a fair market value of $500. The shareholder will be treated as having made a $500 charitable contribution (or a lesser amount if the special rules of section 170(e) apply), and will reduce the basis of the S corporation stock by $200.

Effective Date

The proposal applies to contributions made after the date of enactment.

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[42] Sec. 1366(a)(1)(A).

[43] Sec. 1367(a)(2)(B).

[44] *See* Rev. Rul. 96-11 (1996-1 C.B. 140) for a rule reaching a similar result in the case of charitable contributions made by a partnership.

J. Enhanced Deduction for Charitable Contributions of Literary, Musical, Artistic, and Scholarly Compositions

Present Law

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the deduction generally is limited to the taxpayer's basis in the property.[45] In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions of tangible personal property to a private foundation (other than certain private foundations),[46] the amount of the deduction is limited to the taxpayer's basis in the property.

Under present law, charitable contributions of literary, musical, and artistic compositions created or prepared by the donor are considered ordinary income property and a taxpayer's deduction of such property is limited to the taxpayer's basis (typically, cost) in the property. A charitable contribution of a literary, musical, or artistic composition by a person other than the person who created or prepared the work generally is eligible for a fair market value deduction if the donee organization's use of the property is related to such organization's exempt purposes.

To be eligible for the deduction, the contribution must be of an undivided portion of the donor's entire interest in the property.[47] For purposes of the charitable income tax deduction, the copyright and the work in which the copyright is embodied are not treated as separate property interests. Accordingly, if a donor owns a work of art and the copyright to the work of art, a gift of the artwork without the copyright or the copyright without the artwork will constitute a gift of a "partial interest" and will not qualify for the income tax charitable deduction.

Description of Proposal

The proposal provides that a deduction for "qualified artistic charitable contributions" generally is increased from the value under present law (generally, basis) to the fair market value of the property contributed, measured at the time of the contribution. However, the amount of the increase of the deduction provided by the proposal may not exceed the amount of the donor's adjusted gross income for the taxable year attributable to: (1) income from the sale or use of property created by the personal efforts of the donor that is of the same type as the donated property; and (2) income from teaching, lecturing, performing, or similar activities with respect to such property. In addition, the increase to the present-law deduction provided by the proposal may not be carried over and deducted in other taxable years.

The proposal defines a qualified artistic charitable contribution to mean a charitable contribution of any literary, musical, artistic, or scholarly composition, or similar property, or the

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[45] Sec. 170(e)(1).

[46] Sec. 170(e)(1)(B)(ii).

[47] Sec. 170(f)(3).

copyright thereon (or both) that meets certain requirements. First, the contributed property must have been created by the personal efforts of the donor at least 18 months prior to the date of contribution. Second, the donor must obtain a qualified appraisal of the contributed property, a copy of which is required to be attached to the donor's income tax return for the taxable year in which such contribution is made. The appraisal must include evidence of the extent (if any) to which property created by the personal efforts of the taxpayer and of the same type as the donated property is or has been owned, maintained, and displayed by certain charitable organizations and sold to or exchanged by persons other than the taxpayer, donee, or any related person. Third, the contribution must be made to a public charity or to certain limited types of private foundations. Finally, the use of donated property by the recipient organization must be related to the organization's charitable purpose or function, and the donor must receive a written statement from the organization verifying such use.

Under the proposal, the tangible property and the copyright on such property are treated as separate properties for purposes of the "partial interest" rule; thus, a gift of artwork without the copyright or a copyright without the artwork does not constitute a gift of a partial interest and is deductible. Contributions of letters, memoranda, or similar property that are written, prepared, or produced by or for an individual while the individual is an officer or employee of any person (including a government agency or instrumentality) do not qualify for a fair market value deduction unless the contributed property is entirely personal.

Effective Date

The deduction for qualified artistic charitable contributions applies to contributions made after the date of enactment.

K. Exclusion for Certain Mileage Reimbursements to Charitable Volunteers

Present Law

Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization -- such as out-of-pocket transportation expenses necessarily incurred in performing donated services -- may constitute an itemized deduction for charitable contributions.[48] No charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.[49] In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing services to a charity, the taxpayer either may deduct actual out-of-pocket expenditures or may use the charitable standard mileage rate. The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc.

The charitable standard mileage rate is set by statute at 14 cents per mile.[50] The standard mileage rate for charitable purposes is lower that the standard business rate because the charitable rate covers only the out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the car in performing the donated services that a taxpayer may deduct as a charitable contribution. The charitable rate does not include costs that are not deductible as a charitable contribution such as general repair or maintenance expenses, depreciation, insurance, and registration fees. Such costs are, however, included in computing the business standard mileage rate (the rate allowed for business use of an automobile), which is 36 cents per mile.

Volunteer drivers who are reimbursed for mileage expenses have taxable income to the extent the reimbursement exceeds deductible travel expenses. Employees who are reimbursed for mileage expenses under a qualified arrangement that pays a mileage allowance in lieu of reimbursing actual expenses generally have taxable income to the extent the reimbursement exceeds the amount of the business standard mileage rate multiplied by the actual business miles.

Description of Proposal

Under the proposal, reimbursement by an organization described in section 170(c) (including public charities and private foundations) to a volunteer for the costs of using an automobile in connection with providing donated services is excludable from the gross income of the volunteer, provided that (1) the reimbursement does not exceed the business standard mileage rate prescribed for business use (as periodically adjusted), and (2) recordkeeping requirements applicable to deductible business expenses are satisfied. The proposal does not

[48] Treas. Reg. sec. 1.170A-1(g).

[49] Sec. 170(j).

[50] Sec. 170(i).

permit a volunteer to claim a deduction or credit with respect to excludible expenses. Information reporting required by section 6041 is not required with respect to reimbursements excluded under the proposal.

Effective Date

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

II. PROPOSALS IMPROVING THE OVERSIGHT OF TAX-EXEMPT ORGANIZATIONS

A. Disclosure of Written Determinations

Present Law

In general

Three provisions of present law govern the disclosure of information relating to tax-exempt organizations. First, section 6103 provides a general rule that tax returns and return information generally are not subject to disclosure unless authorized by the Code.[51] Second, in order to allow the public to scrutinize the activities of tax-exempt organizations, section 6104 grants an exception to the confidentiality rule of section 6103 for certain categories of tax-exempt organization documents and information. Third, section 6110 provides that written determinations by the IRS and related background file documents generally are open to public inspection in redacted form. Section 6110 does not apply to any matter to which section 6104 applies.[52]

Disclosure of applications for recognition of tax exemption and annual information returns

Under present law, the IRS is required to make approved applications for recognition of tax-exempt status (and certain related documents)[53] and annual information returns (Form 990 or Form 990-PF) available for public inspection, except that the IRS is not authorized to disclose the names and addresses of contributors (other than contributors to a private foundation).

The Secretary may withhold disclosure of certain information described in an organization's application for tax-exempt status if disclosure would: (1) divulge a trade secret, patent, process, style of work, or apparatus of the organization, and the Secretary determines that such disclosure would harm the organization; or (2) that the Secretary determines would harm the national defense.[54] The organization must apply to the Commissioner for a determination that the disclosure would violate one of these criteria. The organization will be given 15 days to contest an adverse determination before the information is made available for public inspection.[55]

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[51] Sec. 6103(a).

[52] Sec. 6110(l)(1).

[53] Section 6104(a)(1)(A) provides that "any papers submitted in support of" an application for tax-exempt status must be available for inspection. Treasury regulations limit the definition of supporting documents to papers submitted by the organization. Treas. Reg. sec. 301.6104(a)-1(e).

[54] Sec. 6104(a)(1)(D).

[55] Treas. Reg. sec. 301.6104(a)-5(a)(1).

Disclosure of written determinations

Section 6110 provides that the text of any written determination by the IRS and related background file document is open to public inspection.[56] The term "written determination" means a ruling, determination letter, technical advice memorandum, or Chief Counsel advice. Closing agreements, which are final and conclusive written agreements entered into by the IRS and a taxpayer in order to settle the taxpayer's tax liability with respect to a taxable year, do not constitute written determinations.[57]

Before releasing any written determination or background file document, the IRS must delete identifying details of the person about whom the written determination pertains and certain other private information.[58]

The application of section 6110 to guidance relating to tax-exempt organizations is limited to written determinations unrelated to an organization's tax-exempt status. Section 6110(l)(1) provides, "this section shall not apply to any matter to which section 6104 applies." The regulations under section 6110 clarify which matters are within the ambit of section 6104 and, therefore, are not subject to disclosure under section 6110:

> [a]ny application filed with the Internal Revenue Service with respect to the qualification or exempt status of an organization . . .; any document issued by the Internal Revenue Service in which the qualification or exempt status of an organization is . . . granted, denied or revoked or the portion of any document in which technical advice with respect thereto is given to a district director; . . . the portion of any document issued by the Internal Revenue Service in which is discussed the effect on the qualification or exempt status of an organization . . . of proposed transactions by such organization . . . ; and any document issued by the Internal Revenue Service in which is discussed the qualification or status of a [private foundation or private operating foundation].[59]

In addition, the regulations under section 6104 provide that some documents relating to tax exemption that are not open to public inspection under section 6104(a)(1)(A) are nevertheless "within the ambit" of section 6104 for purposes of the disclosure provisions of section 6110.[60]

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[56] Sec. 6110(a). A background file document includes the request for a written determination, any written material submitted by the taxpayer in support of the request, and any communications between the IRS and other persons in connection with the written determination received before issuance of the written determination. Sec. 6110(b)(2).

[57] Sec. 6103(b)(2)(D); sec. 6110(b)(1)(B).

[58] Sec. 6110(c).

[59] Treas. Reg. sec. 301.6110-1(a).

[60] Treas. Reg. sec. 301.6104(a)-1(i).

The regulation explains that the following documents are, therefore, not available for public inspection under either section 6104 or 6110:

(1) unfavorable rulings or determination letters issued in response to applications for tax exemption;

(2) rulings or determination letters revoking or modifying a favorable determination letter;

(3) technical advice memoranda relating to a disapproved application for tax exemption or the revocation or modification of a favorable determination letter;

(4) any letter or document filed with or issued by the IRS relating to whether a proposed or accomplished transaction is a prohibited transaction under section 503;

(5) any letter or document filed with or issued by the IRS relating to an organization's status as a private foundation or private operating foundation, unless the letter or document relates to the organization's application for tax exemption; and

(6) any other letter or document filed with or issued by the IRS which, although it relates to an organization's tax exempt status as an organization described in section 501(c), does not relate to that organization's application for tax exemption.[61]

The effect of these limitations is that written determinations relating to exempt status issues are not released, even in redacted form. The IRS does, however, release under section 6110 written determinations issued to tax-exempt organizations that include issues that clearly are not within the ambit of section 6104, such as the application of the unrelated business income tax to a particular proposed transaction.

Description of Proposal

The proposal provides that the provisions of section 6110 apply to written determinations and related background file documents relating to an organization described in section 501(c) or (d) (including any written determination denying an organization exempt status under such subsection), or to a political organization described in section 527, that are not required to be disclosed by section 6104(a)(1)(A).

Effective Date

The proposal is effective for written determinations issued after the date of enactment.

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[61] *Id.*

B. Disclosure of Internet Web Site and Name Under Which Organization Does Business

Present Law

Most types of tax-exempt organizations are required to file annually an information return.[62] The Internal Revenue Code does not specifically require an exempt organization to furnish on the applicable information return any name under which the organization operates or does business, if such name differs from the legal name of the organization, or the organization's Internet web site address, if any.[63]

Description of Proposal

The proposal requires a tax-exempt organization subject to reporting requirements under section 6033(a) to include on its annual return any name under which such organization operates or does business, and the Internet web site address (if any) of such organization.

Effective Date

The proposal applies to returns filed after December 31, 2003.

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[62] Sec. 6033(a). *See, e.g.*, Form 990 -- Return of Organization Exempt From Income Tax. An organization that is required to file Form 990, but that has gross receipts of less than $100,000 during its taxable year, and total assets of less than $250,000 at the end of its taxable year, may file Form 990-EZ instead of Form 990. Private foundations are required to file Form 990-PF rather than Form 990.

[63] The IRS requires disclosure of an organization's Internet web site address on Forms 990 and 990-EZ.

C. Modification to Reporting of Capital Transactions

Present Law

Private foundations are required to file an annual information return (Form 990-PF).[64] Part IV of the Form 990-PF requires that private foundations report detailed information regarding the gain or loss from the sale or other disposition of property, including a description of the property sold, how it was acquired (purchase or donation), the date acquired, the date sold, the gross sales price, the amount of depreciation allowed or allowable, and the cost or other basis plus expenses of the sale. Such information generally is required for the IRS to calculate the tax on the private foundation's net investment income. The Form 990-PF is required to be made available to the public.

Description of Proposal

The proposal requires that any information regarding capital gains and losses with regard to securities transactions on a listed exchange that is required to be furnished by private foundations in order to calculate the tax on net investment income be furnished also in summary form.

In addition, information regarding capital gains and losses with regard to securities transactions on a listed exchange required to be filed with the IRS but that is not in summary form is not required to be made available to the public by the IRS or by the private foundation except by the explicit request of a member of the public to the IRS or to the foundation. A member of the public may request disclosure of such information from the Secretary, who shall prescribe the manner of making such request and the manner of disclosure. A member of the public also may request disclosure of the private foundation, which must be made in person or in writing. If the request is made in person, the foundation shall provide a copy of the information immediately and, if the request is made in writing, the foundation shall provide the information within 30 days.

The proposal also provides that private foundations are required to state on the furnished summary that the more detailed description is available upon request.

Effective Date

The proposal applies to returns filed after December 31, 2003.

[64] Sec. 6033(a).

D. Disclosure that Form 990 is Publicly Available

Present Law

Under present law, there is no requirement that the IRS notify the public that the Form 990 is publicly available.

Description of Proposal

The proposal requires the IRS to notify the public in appropriate publications and other materials of the extent to which Form 990, Form 990-EZ, or Form 990-PF are publicly available.

Effective Date

The proposal applies to publications or materials issued or revised after the date of enactment.

E. Disclosure to State Officials of Proposed Actions Related to Section 501(c) Organizations

Present Law

In the case of organizations that are described in section 501(c)(3) and exempt from tax under section 501(a) or that have applied for exemption as an organization so described, present law (sec. 6104(c)) requires the Secretary to notify the appropriate State officer of (1) a refusal to recognize such organization as an organization described in section 501(c)(3), (2) a revocation of a section 501(c)(3) organization's tax-exempt status, and (3) the mailing of a notice of deficiency for any tax imposed under section 507, chapter 41, or chapter 42.[65] In addition, at the request of such appropriate State officer, the Secretary is required to make available for inspection and copying, such returns, filed statements, records, reports, and other information relating to the above-described disclosures, as are relevant to any State law determination. An appropriate State officer is the State attorney general, State tax officer, or any State official charged with overseeing organizations of the type described in section 501(c)(3).

In general, return and return information (as such terms are defined in sec. 6103(b)) is confidential and may not be disclosed or inspected unless expressly provided by law.[66] Present law requires the Secretary to keep records of disclosures and requests for inspection[67] and requires that persons authorized to receive return and return information maintain various safeguards to protect such information against unauthorized disclosure.[68] Willful unauthorized disclosure or inspection of return or return information is subject to a fine and/or imprisonment.[69] The knowing or negligent unauthorized inspection or disclosure of returns or return information gives the taxpayer a right to bring a civil suit.[70] Such present-law protections against unauthorized disclosure or inspection of return and return information do not apply to the disclosures or inspections, described above, that are authorized by section 6104(c).

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[65] The applicable taxes include the termination tax on private foundations; taxes on public charities for certain excess lobbying expenses; taxes on a private foundation's net investment income, self-dealing activities, undistributed income, excess business holdings, investments that jeopardize charitable purposes, and taxable expenditures (some of these taxes also apply to certain non-exempt trusts); taxes on the political expenditures and excess benefit transactions of section 501(c)(3) organizations; and certain taxes on black lung benefit trusts and foreign organizations.

[66] Sec. 6103(a).

[67] Sec. 6103(p)(3).

[68] Sec. 6103(p)(4).

[69] Secs. 7213 and 7213A.

[70] Sec. 7431.

Description of Proposal

The proposal provides that upon written request by an appropriate State officer, the Secretary may disclose: (1) a notice of proposed refusal to recognize an organization as a section 501(c)(3) organization; (2) a notice of proposed revocation of tax-exemption of a section 501(c)(3) organization; (3) the issuance of a proposed deficiency of tax imposed under section 507, chapter 41, or chapter 42; (4) the names, addresses, and taxpayer identification numbers of organizations that have applied for recognition as section 501(c)(3) organizations; and (5) returns and return information of organizations with respect to which information has been disclosed under (1) through (4) above.[71] Disclosure or inspection is permitted for the purpose of, and only to the extent necessary in, the administration of State laws regulating section 501(c)(3) organizations, such as laws regulating tax-exempt status, charitable trusts, charitable solicitation, and fraud. Disclosure or inspection may be made only to or by designated representatives of the appropriate State officer, which does not include any contractor or agent. The Secretary also is permitted to disclose or open to inspection the return and return information of an organization that is recognized as tax-exempt under section 501(c)(3), or that has applied for such recognition, to an appropriate State officer if the Secretary determines that disclosure or inspection may facilitate the resolution of Federal or State issues relating to the tax-exempt status of the organization. For this purpose, appropriate State officer means the State attorney general or any other State official charged with overseeing organizations of the type described in section 501(c)(3).

In addition, the proposal provides that upon the written request by an appropriate State officer, the Secretary may make available for inspection or disclosure returns and return information of an organization described in section 501(c)(2) (certain title holding companies), 501(c)(4) (certain social welfare organizations), 501(c)(6) (certain business leagues and similar organizations), 501(c)(7) (certain recreational clubs), 501(c)(8) (certain fraternal organizations), 501(c)(10) (certain domestic fraternal organizations operating under the lodge system), and 501(c)(13) (certain cemetery companies). Such return and return information is available for inspection or disclosure only for the purpose of, and to the extent necessary in, the administration of State laws regulating the solicitation or administration of the charitable funds or charitable assets of such organizations. Disclosure or inspection may be made only to or by designated representatives of the appropriate State officer, which does not include any contractor or agent. For this purpose, appropriate State officer means the State attorney general and the head of an agency designated by the State attorney general as having primary responsibility for overseeing the solicitation of funds for charitable purposes of such organizations.

In addition, the proposal provides that any return and return information disclosed under section 6104(c) may be disclosed in civil administrative and civil judicial proceedings pertaining to the enforcement of State laws regulating the applicable tax-exempt organization in a manner prescribed by the Secretary. Returns and return information are not to be disclosed under section 6104(c), or in such an administrative or judicial proceeding, to the extent that the Secretary determines that such disclosure would seriously impair Federal tax administration. The proposal

[71] Such returns and return information also may be open to inspection by an appropriate State officer.

makes disclosures of returns and return information under section 6104(c) subject to the disclosure, recordkeeping, and safeguard provisions of section 6103, including the requirements that such information remain confidential (sec. 6103(a)(2)), that the Secretary maintain a permanent system of records of requests for disclosure (sec. 6103(p)(3)), and that the appropriate State officer maintain various safeguards that protect against unauthorized disclosure (sec. 6103(p)(4)). The proposal provides that the willful unauthorized disclosure of returns or return information described in section 6104(c) is a felony subject to a fine of up to $5,000 and/or imprisonment of up to five years (sec. 7213(a)(2)), the willful unauthorized inspection of returns or return information described in section 6104(c) is subject to a fine of up to $1,000 and/or imprisonment of up to one year (sec. 7213A), and provides the taxpayer the right to bring a civil action for damages in the case of knowing or negligent unauthorized disclosure or inspection of such information (sec. 7431(a)(2)).

Effective Date

The proposal is effective on the date of enactment but does not apply to requests made before such date.

F. Expansion of Penalties to Preparers of Form 990

Present Law

Under present law, income tax return preparers are subject to a penalty of $250 with respect to any return if a portion of an understatement of tax liability is due to a position for which there was not a realistic possibility of success on the merits, the preparer knew or reasonably should have known of the position, and the position was not disclosed or was frivolous.[72] In addition, present law imposes a penalty on income tax return preparers of $1,000 with respect to a tax return if a portion of an understatement of tax liability is due to a willful attempt to understate liability or to reckless or intentional disregard of rules or regulations.[73]

Description of Proposal

The proposal provides that a preparer (for compensation) of an information return of an exempt organization is subject to a penalty of $250 if the preparer omits or misrepresents any information with respect to such return that was known or should have been known by the preparer. The penalty does not apply to minor, inadvertent omissions.

In addition, a preparer of such an information return is subject to a penalty of $1,000 if the preparer recklessly or intentionally misrepresents any information or recklessly or intentionally disregards any rule or regulation with respect to such return. With respect to any return, the $1,000 penalty is reduced by the amount of any penalty paid by such person with respect to the return for omissions and misrepresentations (the $250 penalty imposed by the proposal) or a penalty imposed by section 6694.

Effective Date

The proposal is effective for documents prepared after the date of enactment.

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[72] Sec. 6694(a).

[73] Sec. 6694(b).

G. Notification Requirement for Exempt Entities not Currently Required to File an Annual Information Return

Present Law

Under present law, the requirement that an exempt organization file an annual information return does not apply to several categories of exempt organizations. Organizations excepted from the filing requirement include organizations (other than private foundations), the gross receipts of which in each taxable year normally are not more than $25,000.[74] Also exempt from the requirement are churches, their integrated auxiliaries, and conventions or associations of churches; the exclusively religious activities of any religious order; section 501(c)(1) instrumentalities of the United States; section 501(c)(21) trusts; an interchurch organization of local units of a church; certain mission societies; certain church-affiliated elementary and high schools; certain state institutions whose income is excluded from gross income under section 115; certain governmental units and affiliates of governmental units; and organizations that the IRS has relieved from the filing requirement pursuant to its statutory discretionary authority.

Description of Proposal

The proposal provides that organizations that are excused from filing an information return by reason of normally having gross receipts in each taxable year of not more than $25,000 shall furnish to the Secretary annually the legal name of the organization, any name under which the organization operates or does business, the organization's mailing address and Internet web site address (if any), the organization's taxpayer identification number, the name and address of a principal officer, and evidence of the organization's continuing basis for its exemption from the generally applicable information return filing requirements. Upon such organization's termination of existence, the organization is required to furnish notice of such termination.

The proposal provides that if an organization fails to provide the required notice for three consecutive years, the organization's tax-exempt status is revoked. If upon reapplication for tax-exempt status, the organization shows to the satisfaction of the Secretary reasonable cause for failing to file the required annual notices, the organization's tax-exempt status will be reinstated retroactive to the date of revocation. An organization may not challenge under the Code's declaratory judgment procedures (section 7428) a revocation of tax-exemption made pursuant to the proposal. There is no monetary penalty for failure to file the notice. The proposal does not require that the notices be made available to the public under the public disclosure and inspection rules generally applicable to exempt organizations.

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[74] Sec. 6033(a)(2); Treas. Reg. sec. 1.6033-2(a)(2)(i); Treas. Reg. sec. 1.6033-2(g)(1). Sec. 6033(a)(2)(A)(ii) provides a $5,000 annual gross receipts exception from the annual reporting requirements for certain exempt organizations. In Announcement 82-88, 1982-25 I.R.B. 23, the IRS exercised its discretionary authority under section 6033 to increase the gross receipts exception to $25,000, and enlarge the category of exempt organizations that are not required to file Form 990.

The Secretary is required to notify in a timely manner every organization that is subject to the filing requirement of the new filing obligation. The notice shall be by mail, in the case of any organization the identity and address of which is included in the list of exempt organizations maintained by the Secretary, and by Internet or other means of outreach, in the case of any other organization. The Secretary is authorized to publish a list of organizations whose exempt status is revoked under the proposal.

Effective Date

The proposal is effective for notices with respect to annual periods beginning after 2003.

H. Suspension of Tax-Exempt Status of Terrorist Organizations

Present Law

Under present law, the Internal Revenue Service generally issues a letter revoking recognition of an organization's tax-exempt status only after (1) conducting an examination of the organization, (2) issuing a letter to the organization proposing revocation, and (3) allowing the organization to exhaust the administrative appeal rights that follow the issuance of the proposed revocation letter. In the case of an organization described in section 501(c)(3), the revocation letter immediately is subject to judicial review under the declaratory judgment procedures of section 7428. To sustain a revocation of tax-exempt status under section 7428, the IRS must demonstrate that the organization is no longer entitled to exemption. There is no procedure under current law for the IRS to suspend the tax-exempt status of an organization.

To combat terrorism, the Federal government has designated a number of organizations as terrorist organizations or supporters of terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945.

Description of Proposal

The proposal suspends the tax-exempt status of an organization that is exempt from tax under section 501(a) for any period during which the organization is designated or identified by U.S. Federal authorities as a terrorist organization or supporter of terrorism. The proposal also makes such an organization ineligible to apply for tax exemption under section 501(a). The period of suspension runs from the date the organization is first designated or identified to the date when all designations or identifications with respect to the organization have been rescinded pursuant to the law or Executive order under which the designation or identification was made.

The proposal describes a terrorist organization as an organization that has been designated or otherwise individually identified (1) as a terrorist organization or foreign terrorist organization under the authority of section 212(a)(3)(B)(vi)(II) or section 219 of the Immigration and Nationality Act; (2) in or pursuant to an Executive order that is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive order that refers to the proposal and is issued under the authority of any Federal law if the organization is designated or otherwise individually identified in or pursuant to such Executive order as supporting or engaging in terrorist activity (as defined in section 212(a)(3)(B) of the Immigration and Nationality Act) or supporting terrorism (as defined in section 140(d)(2) of the Foreign Relations Authorization Act, Fiscal Years 1988 and 1989). During the period of suspension, no deduction for any contribution to a terrorist organization is allowed under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522.

No organization or other person may challenge, under section 7428 or any other provision of law, in any administrative or judicial proceeding relating to the Federal tax liability of such organization or other person, the suspension of tax-exemption, the ineligibility to apply

for tax-exemption, a designation or identification described above, the timing of the period of suspension, or a denial of deduction described above. The suspended organization may maintain other suits or administrative actions against the agency or agencies that designated or identified the organization, for the purpose of challenging such designation or identification (but not the suspension of tax-exempt status under this provision).

If the tax-exemption of an organization is suspended and each designation and identification that has been made with respect to the organization is determined to be erroneous pursuant to the law or Executive order making the designation or identification, and such erroneous designation results in an overpayment of income tax for any taxable year with respect to such organization, a credit or refund (with interest) with respect to such overpayment shall be made. If the operation of any law or rule of law (including res judicata) prevents the credit or refund at any time, the credit or refund may nevertheless be allowed or made if the claim for such credit or refund is filed before the close of the one-year period beginning on the date that the last remaining designation or identification with respect to the organization is determined to be erroneous.

The proposal directs the IRS to update the listings of tax-exempt organizations to take account of organizations that have had their exemption suspended and to publish notice to taxpayers of the suspension of an organization's tax-exemption and the fact that contributions to such organization are not deductible during the period of suspension.

Effective Date

The proposal is effective on the date of enactment.

III. OTHER CHARITABLE AND EXEMPT ORGANIZATION PROPOSALS

A. Modify Tax on Unrelated Business Taxable Income of Charitable Remainder Trusts

Present Law

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax for a tax year unless the trust has any unrelated business taxable income for the year. Unrelated business taxable income includes certain debt financed income. A charitable remainder trust that loses exemption from income tax for a taxable year is taxed as a regular complex trust. As such, the trust is allowed a deduction in computing taxable income for amounts required to be distributed in a taxable year, not to exceed the amount of the trust's distributable net income for the year. Taxes imposed on the trust are required to be allocated to corpus.[75]

Distributions from a charitable remainder annuity trust or charitable remainder unitrust are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred, (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred, (3) other income (e.g., tax-exempt income) to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred, and (4) corpus.[76]

In general, distributions to the extent they are characterized as income are includible in the income of the beneficiary for the year that the annuity or unitrust amount is required to be distributed even though the annuity or unitrust amount is not distributed until after the close of the trust's taxable year.[77]

A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a noncharity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a noncharity for the life of an individual or for a period 20 years or less, with the remainder passing to charity.[78]

A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not

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[75] Treas. Reg. sec. 1.664-1(d)(2).

[76] Sec. 664(b).

[77] Treas. Reg. sec. 1.664-1(d)(4).

[78] Sec. 664(d).

qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust.

Description of Proposal

The proposal imposes a 100-percent excise tax on the unrelated business taxable income of a charitable remainder trust. This replaces the present-law rule that takes away the income tax exemption of a charitable remainder trust for any year in which the trust has any unrelated business taxable income. Consistent with present law, the tax is treated as paid from corpus. The unrelated business taxable income is considered income of the trust for purposes of determining the character of the distribution made to the beneficiary.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

B. Modify Tax Treatment of Certain Payments to Controlling Exempt Organizations

Present Law

In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations. However, section 512(b)(13) generally treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business income if such income is received from a taxable or tax-exempt subsidiary that is 50 percent controlled by the parent tax-exempt organization. In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, control means ownership of more than 50 percent of the profits, capital or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

Under present law, interest, rent, annuity, or royalty payments made by a controlled entity to a tax-exempt organization are includable in the latter organization's unrelated business income and are subject to the unrelated business income tax to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt).

The Taxpayer Relief Act of 1997 (the "1997 Act") made several modifications to the control requirement of section 512(b)(13). In order to provide transitional relief, the changes made by the 1997 Act do not apply to any payment received or accrued during the first two taxable years beginning on or after the date of enactment of the 1997 Act (August 5, 1997) if such payment is received or accrued pursuant to a binding written contract in effect on June 8, 1997, and at all times thereafter before such payment (but not pursuant to any contract provision that permits optional accelerated payments).

Description of Proposal

The proposal provides that the general rule of section 512(b)(13), which includes interest, rent, annuity, or royalty payments made by a controlled entity to a tax-exempt organization in the latter organization's unrelated business income to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity, applies only to the portion of payments received or accrued in a taxable year that exceed the amount of the specified payment that would have been paid or accrued if such payment had been determined under the principles of section 482. Thus, if a payment of rent by a controlled subsidiary to its tax-exempt parent organization exceeds fair market value, the excess amount of such payment over fair market value (as determined in accordance with section 482) is included in the parent organization's unrelated business income, to the extent that such excess reduced the net unrelated income (or increased any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt). In addition, the provision imposes a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

The proposal provides that if modifications to section 512(b)(13) made by the 1997 Act did not apply to a contract because of the transitional relief provided by the 1997 Act, then such modifications also do not apply to amounts received or accrued under such contract before January 1, 2001.

Effective Date

The proposal applies to payments received or accrued after December 31, 2000.

C. Simplification of Lobbying Expenditure Limitation

Present Law

In general

An organization does not qualify for tax-exempt status under section 501(c)(3) unless "no substantial part" of the activities of the organization is "carrying on propaganda, or otherwise attempting, to influence legislation," except as provided by section 501(h).[79] Carrying on propaganda and attempting to influence legislation commonly are referred to as "lobbying" activities. Thus, section 501(c)(3) permits a limited amount of lobbying activity without loss of tax-exempt status.

For purposes of determining whether lobbying activities are a substantial part of an organization's overall functions, an organization generally may choose between two standards, the "no substantial part" test of section 501(c)(3) or the "expenditure" test of section 501(h).

Whether an organization meets the "no substantial part" test is based on all the facts and circumstances. There is no statutory or regulatory guidance, and it is not clear whether the determination is based on the organization's activities, its expenditures, or both. Alternatively, under section 501(h), certain organizations described in section 501(c)(3) can elect to be subject to the expenditure test,[80] which consists of bright-line rules that specify the dollar amount of permitted expenditures on lobbying activities.

Consequences of excess lobbying under section 501(h)

Organizations that make a section 501(h) election ("electing charities") are subject to tax if the electing charity makes either "lobbying expenditures" or "grass roots expenditures" in excess of a certain amount established for each type of expenditure for each taxable year. Lobbying expenditures are the sum of grass-roots expenditures and "direct lobbying" expenditures.[81]

The expenditure limits are based on a "lobbying nontaxable amount" for the taxable year and a "grass roots nontaxable amount" for the taxable year. The lobbying nontaxable amount is the lesser of $1 million or an amount determined as a percentage of an organization's exempt purpose expenditures.[82] The grass-roots nontaxable amount is 25 percent of the organization's

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[79] Sec. 501(c)(3).

[80] Organizations that do not make a section 501(h) election are subject to the "no substantial part" test.

[81] Secs. 501(h)(2)(A), 4911(c)(1), 4911(d).

[82] Exempt purpose expenditures generally are expenses incurred for exempt purposes, such as amounts paid to accomplish exempt purposes, administrative expenses such as overhead, lobbying expenses, and certain fundraising expenses. Exempt purpose expenditures do not include, for example, expenses not for exempt purposes, payments of unrelated business income

lobbying nontaxable amount. An electing charity that exceeds either of the spending limitations is subject to a 25 percent tax on the excess. An electing charity that exceeds both of the spending limitations is subject to a 25 percent tax on the greater of the excess of the lobbying expenditures or the grass-roots expenditures.

An electing charity that normally exceeds either of two "ceiling amounts," which are based on the expenditure limits, will lose its tax exemption.[83] The "lobbying ceiling amount" is 150 percent of the electing charity's lobbying nontaxable amount for the taxable year and the "grass roots ceiling amount" is 150 percent of the grass-roots nontaxable amount for the taxable year. For this purpose, "normal" expenditures are calculated based on a four-year averaging mechanism.[84]

Definitions

Grass-roots expenditures are defined as "any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof."[85] For a communication to constitute grass-roots lobbying, it must refer to "specific legislation," reflect a view on such legislation, and encourage the recipient of the communication to take action with respect to such legislation (a "call to action").[86] A communication includes a call to action if it incorporates one of four elements: (1) it urges the recipient to contact a legislator, employee of a government body, or any other government official or employee who may participate in the formulation of legislation with the principal purpose of influencing legislation; (2) it states the address, telephone number, or similar information of a legislator or an employee of a legislative body; (3) it provides a petition, tear-off postcard, or similar device for the recipient to communicate with government officials or employees who participate in the formulation of legislation with the principal purpose of influencing legislation; or (4) it states the position of one or more legislators on the legislation, except that a communication may name the main sponsors of legislation for purposes of identifying the legislation without constituting a call to action.[87] In

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tax, or capital expenses in connection with an unrelated business. See Treas. Reg. sec. 56.4911-4.

[83] Sec. 501(h)(1).

[84] Treas. Reg. sec. 1.501(h)-3.

[85] Secs. 501(h)(2)(C) & 4911(d)(1)(A).

[86] Treas. Reg. sec. 56.4911-2(b)(2)(i).

[87] Treas. Reg. sec. 56.4911-2(b)(2)(iii). The regulations provide that the first three elements constitute "direct" encouragement, whereas the fourth element is "indirect" encouragement. This distinction becomes relevant in determining whether a communication meets one of the prescribed exceptions to lobbying, i.e., an indirect call to action in a grass-roots communication may qualify as "nonpartisan analysis, study or research" (Treas. Reg. sec. 56.4911-2(b)(2)(iv)), and in determining the proper allocation of expenses between grass-roots and direct lobbying. Treas. Reg. sec. 56.4911-5(e).

addition, a communication is presumed to be grass-roots lobbying if the communication is a paid advertisement that: (1) appears in the mass media within two weeks before a vote by a legislative body or committee (but not a subcommittee) on a highly publicized piece of legislation; (2) reflects a view on the general subject of the legislation; and (3) either refers to the legislation or encourages the public to communicate with legislators on the general subject of such legislation.[88] The presumption is rebuttable if the electing charity demonstrates that the timing of the communication was not related to the legislation or that the advertisement was of a type regularly made by the electing charity without regard to the timing of the legislation (a customary course of business exception).[89]

Direct lobbying expenditures are "any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation" if the principal purpose of the communication is to influence legislation.[90] A communication would constitute direct lobbying only if the communication "refers to specific legislation" and reflects a view on such legislation.

Certain specified activities do not constitute attempts to influence legislation and therefore expenditures for such activities are not subject to the expenditure limits for lobbying expenditures or grass-roots expenditures. In general, such activities include: (1) making available the results of nonpartisan analysis, study, or research; (2) providing technical advice or assistance to a governmental body or to a committee in response to a written request; (3) appearances before, or communications to, any legislative body with respect to a possible decision of such body that might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization (so-called "self-defense" expenditures); (4) certain communications to members of the electing charity; and (5) communications with governmental officials or employees that are not intended to influence legislation.[91]

<u>**Special rules for mixed lobbying expenditures**</u>

Expenses that serve both direct and grass-roots lobbying purposes, e.g., communications that are sent to members and nonmembers, or "mixed lobbying" expenditures, are subject to special rules. The regulations specify how an electing charity is to allocate mixed lobbying expenditures between direct and grass-roots lobbying purposes.[92] For example, for a mixed lobbying communication that is designed primarily for members (i.e., more than half the recipients are members) and that directly encourages grass-roots lobbying (even if it also

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[88] Treas. Reg. sec. 56.4911-2(b)(5)(ii).

[89] *Id.*

[90] Secs. 501(h)(2)(A) and 4911(d)(1)(B) and Treas. Reg. sec. 56.4911-2(b)(1).

[91] Sec. 4911(d)(2).

[92] Treas. Reg. sec. 56.4911-5(e).

encourages direct lobbying), the grass-roots expenditure amount includes all the costs of preparing the material used for purposes of grass-roots lobbying plus the mechanical and distributional costs associated with the communication. If a mixed lobbying communication encourages direct lobbying, but only indirectly encourages grass-roots lobbying, then the entire costs of the communication are allocated based on the proportion of members and nonmembers receiving the communication.

Disclosure of lobbying expenditures

An electing charity must disclose lobbying expenditures annually on Schedule A of Form 990. In order to meet disclosure requirements, electing charities are required to keep detailed records of direct and grass-roots lobbying expenditures. Required records of grass-roots expenditures include: (1) all amounts directly paid or incurred for grass-roots lobbying; (2) payments to other organizations earmarked for grass-roots lobbying; (3) fees and expenses paid for grass-roots lobbying; (4) the printing, mailing, and other costs of reproducing and distributing materials used in grass-roots lobbying; (5) the portion of amounts paid or incurred as current or deferred compensation for an employee's grass-roots lobbying services; (6) any amount paid for out-of-pocket expenditures incurred on behalf of the electing charity for grass-roots lobbying; (7) the allocable portion of administrative, overhead and other general expenditures attributable to grass-roots lobbying; and (8) expenditures for grass-roots lobbying of a controlled organization.[93]

Description of Proposal

The proposal eliminates the separate limitation for grass-roots lobbying expenditures applicable to electing charities. Electing charities remain subject to the overall limitation on lobbying expenditures, which does not change in amount, but electing charities are not required to limit grass roots expenditures as a percentage of overall lobbying. Thus, an electing charity is able to make tax-free any combination of grass-roots and direct lobbying expenditures up to the lobbying non-taxable amount and does not risk loss of tax-exemption as a result of such expenditures until total lobbying expenditures normally exceed the lobbying ceiling amount. For purposes of the section 501(h) election, electing charities are not required to distinguish between grass-roots lobbying and direct lobbying, whether for mixed lobbying expenditures or otherwise.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

[93] *See* Treas. Reg. sec. 56.4911-6.

D. Expedited Review Process for Certain Tax-Exemption Applications

Present Law

Most organizations that seek tax-exempt status as a charitable organization are required to file an Application for Recognition of Exemption (Form 1023) with the IRS.[94] Organizations that are not required to file Form 1023 include churches, their integrated auxiliaries, and conventions or associations of churches, and any organization (other than a private foundation) that normally has gross receipts of $5,000 or less in a taxable year. Organizations that file Form 1023 within 15 months of the end of the month of the organization's formation will, if the application is approved, be recognized as tax-exempt from the date of formation. The IRS will automatically grant an organization's request for an additional 12-month extension of the 15-month period. Otherwise, exemption normally will be recognized as of the date the application was received by the IRS. In appropriate circumstances, upon written request, the IRS will expedite consideration of applications for tax-exemption. For example, organizations formed to provide relief to victims of disasters or other emergencies often receive expedited consideration.

Description of Proposal

The proposal provides that the Secretary or his delegate shall adopt procedures to expedite consideration of applications for exempt status by organizations that are organized and operated for the primary purpose of providing social services. To be eligible, the organization must: (1) be seeking a contract or grant under a Federal, State, or local program that provides funding for social service programs; (2) establish that tax-exempt status is a condition of applying for such contract or grant; (3) include a completed copy of the contract or grant application with the application for exemption; and (4) meet such other criteria as the Secretary may provide. Organizations that meet the eligibility requirements described above (except for the requirement that tax-exempt status is a condition of the contract or grant application), and that certify that the organization's average annual gross receipts over the four year period preceding the application was not more than $50,000 (or, in the case of an organization in existence less than four years, is not expected to be more than $50,000 during the organization's first four years) are entitled to a waiver of any fee for application of tax-exempt status.

For this purpose, social services is defined as services directed at helping people in need, reducing poverty, improving outcomes of low-income children, revitalizing low-income communities, and empowering low-income families and low-income individuals to become self-sufficient, including: (1) child care services, protective services for children and adults, services for children and adults in foster care, adoption services, services related to the management and maintenance of the home, day care services for adults, and services to meet the special needs of children, older individuals, and individuals with disabilities (including physical, mental, or emotional disabilities); (2) transportation services; (3) job training and related services, and employment services; (4) information, referral, and counseling services; (5) the preparation and delivery of meals, and services related to soup kitchens or food banks; (6) health support services; (7) literacy and mentoring programs; (8) services for the prevention and treatment of

[94] Sec. 508(a).

juvenile delinquency and substance abuse, services for the prevention of crime and the provision of assistance to the victims and the families of criminal offenders, and services related to the intervention in, and prevention of, domestic violence; and (9) services related to the provision of assistance for housing under Federal law. Social services does not include a program having the purpose of delivering educational assistance under the Elementary and Secondary Education Act of 1965 or under the Higher Education Act of 1965.

Effective Date

The proposal applies to applications for tax-exempt status filed after December 31, 2003.

E. Clarification of Definition of Church Tax Inquiry

Present Law

Under present law, the IRS may begin a church tax inquiry only if an appropriate high-level Treasury official reasonably believes, on the basis of the facts and circumstances recorded in writing, that an organization (1) may not qualify for tax exemption as a church, (2) may be carrying on an unrelated trade or business, or (3) otherwise may be engaged in taxable activities.[95] A church tax inquiry is defined as any inquiry to a church (other than an examination) that serves as a basis for determining whether the organization qualified for tax exemption as a church or whether it is carrying on an unrelated trade or business or otherwise is engaged in taxable activities. An inquiry is considered to commence when the IRS requests information or materials from a church of a type contained in church records, other than routine requests for information or inquiries regarding matters that do not primarily concern the tax status or liability of the church itself.

Description of Proposal

The proposal clarifies that the church tax inquiry procedures do not apply to contacts made by the IRS for the purpose of educating churches with respect to the federal income tax law governing tax-exempt organizations. For example, the IRS does not violate the church tax inquiry procedures when written materials are provided to a church or churches for the purpose of educating such church or churches with respect to the types of activities that are not permissible under section 501(c)(3).

Effective Date

The proposal is effective on the date of enactment.

[95] Sec. 7611. Prior to the year 2000 IRS restructuring, the lowest level official who could initiate a church tax inquiry was an IRS Regional Commissioner.

F. Extension of Declaratory Judgment Procedures to Non-501(c)(3) Tax-Exempt Organizations

Present Law

In order for an organization to be granted tax exemption as a charitable entity described in section 501(c)(3), it generally must file an application for recognition of exemption with the IRS and receive a favorable determination of its status. Similarly, for most organizations, a charitable organization's eligibility to receive tax-deductible contributions is dependent upon its receipt of a favorable determination from the IRS. In general, a section 501(c)(3) organization can rely on a determination letter or ruling from the IRS regarding its tax-exempt status, unless there is a material change in its character, purposes, or methods of operation. In cases in which an organization violates one or more of the requirements for tax exemption under section 501(c)(3), the IRS is authorized to revoke an organization's tax exemption, notwithstanding an earlier favorable determination.

In situations in which the IRS denies an organization's application for recognition of exemption under section 501(c)(3) or fails to act on such application, or in which the IRS informs a section 501(c)(3) organization that it is considering revoking or adversely modifying its tax-exempt status, present law authorizes the organization to seek a declaratory judgment regarding its tax status (sec. 7428). Section 7428 provides a remedy in the case of a dispute involving a determination by the IRS with respect to: (1) the initial qualification or continuing qualification of an organization as a charitable organization for tax exemption purposes or for charitable contribution deduction purposes; (2) the initial classification or continuing classification of an organization as a private foundation; (3) the initial classification or continuing classification of an organization as a private operating foundation; or (4) the failure of the IRS to make a determination with respect to (1), (2), or (3). A "determination" in this context generally means a final decision by the IRS affecting the tax qualification of a charitable organization, although it also can include a proposed revocation of an organization's tax-exempt status or public charity classification. Section 7428 vests jurisdiction over controversies involving such a determination in the U.S. District Court for the District of Columbia, the U.S. Court of Federal Claims, and the U.S. Tax Court.

Prior to utilizing the declaratory judgment procedure, an organization must have exhausted all administrative remedies available to it within the IRS. An organization is deemed to have exhausted its administrative remedies at the expiration of 270 days after the date on which the request for a determination was made if the organization has taken, in a timely manner, all reasonable steps to secure such determination.

If an organization (other than a section 501(c)(3) organization) files an application for recognition of exemption and receives a favorable determination from the IRS, the determination of tax-exempt status is usually effective as of the date of formation of the organization if its purposes and activities during the period prior to the date of the determination letter were consistent with the requirements for exemption. However, if the organization files an application for recognition of exemption and later receives an adverse determination from the IRS, the IRS may assert that the organization is subject to tax on some or all of its income for open taxable

years. In addition, as with charitable organizations, the IRS may revoke or modify an earlier favorable determination regarding an organization's tax-exempt status.

Under present law, a non-charity (i.e., an organization not described in section 501(c)(3)) may not seek a declaratory judgment with respect to an IRS determination regarding its tax-exempt status. The only remedies available to such an organization are to petition the U.S. Tax Court for relief following the issuance of a notice of deficiency or to pay any tax owed and sue for refund in federal district court or the U.S. Court of Federal Claims.

Description of Proposal

The proposal extends declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) and 501(d) determinations. The proposal limits jurisdiction over controversies involving such other determinations to the United States Tax Court.[96]

Effective Date

The extension of the declaratory judgment procedures to organizations other than section 501(c)(3) organizations is effective for pleadings filed with respect to determinations (or requests for determinations) made after December 31, 2002.

[96] This limitation currently applies to declaratory judgments relating to tax qualification for certain employee retirement plans (sec. 7476).

G. Definition of Convention or Association of Churches

Present Law

Under present law, an organization that qualifies as a "convention or association of churches" (within the meaning of sec. 170(b)(1)(A)(i)) is not required to file an annual return,[97] is subject to the church tax inquiry and church tax examination provisions applicable to organizations claiming to be a church,[98] and is subject to certain other provisions generally applicable to churches.[99] The Internal Revenue Code does not define the term "convention or association of churches."

Description of Proposal

The proposal provides that an organization that otherwise is a convention or association of churches does not fail to so qualify merely because the membership of the organization includes individuals as well as churches, or because individuals have voting rights in the organization.

Effective Date

The proposal is effective on the date of enactment.

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[97] Sec. 6033(a)(2)(A)(i).

[98] Sec. 7611(h)(1)(B).

[99] *See, e.g.*, Sec. 402(g)(8)(B) (limitation on elective deferrals); sec. 403(b)(9)(B) (definition of retirement income account); sec. 410(d) (election to have participation, vesting, funding, and certain other provisions apply to church plans); sec. 414(e) (definition of church plan); sec. 415(c)(7) (certain contributions by church plans); sec. 501(h)(5) (disqualification of certain organizations from making the sec. 501(h) election regarding lobbying expenditure limits); sec. 501(m)(3) (definition of commercial-type insurance); sec. 508(c)(1)(A) (exception from requirement to file application seeking recognition of exempt status); sec. 512(b)(12) (allowance of up to $1,000 deduction for purposes of determining unrelated business taxable income); sec. 514(b)(3)(E) (definition of debt-financed property); sec. 3121(w)(3)(A) (election regarding exemption from social security taxes); sec. 3309(b)(1) (application of federal unemployment tax provisions to services performed in the employ of certain organizations); sec. 6043(b)(1) (requirement to file a return upon liquidation or dissolution of the organization); and sec. 7702(j)(3)(A) (treatment of certain death benefit plans as life insurance).

H. Payments by Charitable Organizations to Victims of War on Terrorism

Present Law

In general, organizations described in section 501(c)(3) of the Code are exempt from taxation. Contributions to such organizations generally are tax deductible.[100] Section 501(c)(3) organizations must be organized and operated exclusively for exempt purposes and no part of the net earnings of such organizations may inure to the benefit of any private shareholder or individual. An organization is not organized or operated exclusively for one or more exempt purposes unless the organization serves a public rather than a private interest. Thus, an organization described in section 501(c)(3) generally must serve a charitable class of persons that is indefinite or of sufficient size.

Tax-exempt private foundations are a type of organization described in section 501(c)(3) and are subject to special rules. Private foundations are subject to excise taxes on acts of self-dealing between the private foundation and a disqualified person with respect to the foundation.[101] For example, it is self-dealing if assets of a private foundation are used for the benefit of a disqualified person, such as a substantial contributor to the foundation or a person in control of the foundation, and the benefit is not incidental or tenuous.

Description of Proposal

The proposal provides that organizations described in section 501(c)(3) that make certain payments are not required to make a specific assessment of need for the payments to be related to the purpose or function constituting the basis for the organization's exemption, provided that the organization makes the payments in good faith and uses an objective formula that is consistently applied in making the payments.

The proposal applies to payments to a member of the Armed Forces of the United States (as defined in section 7701(a)(15)), or to a member of such person's immediate family (including spouses, parents, children, and foster children), by reason of the death, injury, wounding, or illness of a member of the Armed Forces of the United States that was incurred as a result of the military response of the United States to the terrorist attacks against the United States on September 11, 2001. As under present law, such payments must be for public and not private benefit and therefore must serve a charitable class. For example, a charitable organization that assists the families of members of the Armed Forces killed in the line of duty may make pro-rata distributions to the families of those killed, even though the specific financial needs of each family are not directly considered. Similarly, if the amount of a distribution is based on the number of dependents of a charitable class of persons killed in the military response to the attacks and this standard is applied consistently among distributions, the specific needs of each recipient do not have to be taken into account. However, it is not appropriate for a charity to make pro-rata payments based on the recipients' living expenses before the harm occurred if the result generally provides significantly greater assistance to persons in a better position to provide

[100] Sec. 170.

[101] Sec. 4941.

for themselves than to persons with fewer financial resources. Although such a distribution might be based on objective criteria, it is not a reasonable formula for distributing assistance in an equitable manner. Similarly, although specific assessments of need are not required, payments that do not further public purposes are not permitted. The proposal does not change the substantive standards for exemption under section 501(c)(3), including the prohibition on private inurement. The proposal also provides that if a private foundation makes payments under the conditions described above, the payment is not treated as made to a disqualified person for purposes of section 4941.

Effective Date

The proposal applies to payments made after the date of enactment and before September 11, 2004.

I. Increase Percentage Limits for Certain Employer-Related Scholarship Programs

Present Law

Gross income does not include any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization (sec. 117(a)). For this purpose, a scholarship generally means an amount paid or allowed to, or for the benefit of, a student to aid that student in pursuing studies.[102] However, an amount paid or allowed to, or on behalf of, an individual to enable the individual to pursue studies is not treated as a scholarship if the amount represents compensation for past, present, or future services.[103] The determination of whether an amount is properly treated as a scholarship or compensation for services is made in light of all the relevant facts and circumstances.

Present law imposes excise taxes on the taxable expenditures of a private foundation.[104] A taxable expenditure includes, among other things, any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant is awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary.[105] In the case of individual grants to be made as scholarships or fellowships, the private foundation must demonstrate to the satisfaction of the Secretary that the grant: (1) constitutes a scholarship or fellowship which would be subject to the provisions of section 117(a),[106] and (2) is to be used for study at an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.[107]

Private foundations may in the course of their activities make scholarship or fellowship grants to individuals to be used for educational purposes. However, a private foundation's grant program may not be designed or administered to the end of providing compensation, an employment incentive, or an employee fringe benefit to persons employed by the foundation or by another employer (including, for example, employees of a "related" employer organization). Revenue Procedure 76-47 provides advance approval guidelines to determine whether grants made by private foundations under employer-related grant programs to an employee or to a child of an employee of the employer to which the program relates is considered a scholarship or

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[102] Treas. Reg. sec. 1.117-3(a).

[103] Treas. Reg. sec. 1.117-4(c).

[104] Secs. 4945(a) and (b).

[105] Secs. 4945(d)(3) and (g).

[106] For the purpose of section 4945(g), the term "scholarship or fellowship" refers to the provisions of section 117(a) as in effect before the Tax Reform Act of 1986. Sec. 4945(g)(1).

[107] Secs. 4945(g)(1) and 170(b)(1)(A)(ii).

fellowship grant subject to the provisions of section 117(a).[108] To the extent that such grants are considered scholarships or fellowships under these guidelines, the Secretary will assume the grants are not taxable expenditures subject to section 4945 taxes. Educational grants that are not scholarships or fellowships under these guidelines might, depending upon the circumstances, lead to a loss of the private foundation's exempt status.

Under Revenue Procedure 76-47, a grant made under an employer-related grant program that satisfies seven conditions and a percentage test is considered a scholarship or fellowship.[109] Grants awarded to children of employees and to employees are considered as having been awarded under separate programs for purposes of the revenue procedure, regardless of whether they are awarded under separately administered programs. All such grants must satisfy each of the seven conditions to obtain advance approval of the grant program. The percentage test applicable to grants to children of employees requires that the number of grants awarded not exceed either 25 percent of the eligible applicants considered by the selection committee in selecting grant recipients or 10 percent of those eligible for grants (regardless of whether they submitted grant applications). The percentage test applicable to grants to employees requires that the number of grants awarded not exceed 10 percent of eligible applicants considered by the selection committee in selecting grant recipients. If the seven conditions are met, but the relevant percentage test is not satisfied, then the question of whether the grants constitute scholarships or fellowships is based upon all of the facts and circumstances.

Similar requirements and percentage limits apply to determine whether educational loans made by a private foundation under an employer-related loan program are taxable expenditures.[110] If an employer-related program encompasses educational loans and scholarship

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[108] Rev. Proc. 76-47, 1976-2 C.B. 670. The revenue procedure defines an employer-related program as a program that treats some or all of the employees, or children of some or all of the employees, of an employer as a group from which grantees of some or all of the grants will be selected, limits the potential grantees for some or all of the grants to individuals who are employees or children of employees of an employer, or otherwise gives such individuals a preference or priority over others in being selected as grantees.

[109] The seven conditions include: (1) the program must not be used to recruit employees, to induce employees to continue their employment, or to compel a course of action sought by the employer; (2) the selection of grant recipients must be made by a committee consisting of independent individuals; (3) the program must impose identifiable minimum requirements for grant eligibility; (4) the selection of grant recipients must be based solely upon substantial objective standards that are completely unrelated to employment and to the employer's line of business; (5) a grant may not be terminated because the recipient or the recipient's parent terminates employment with the employer; (6) the courses of study for which grants are available must not be limited to those would be of particular benefit to the employer or the foundation; and (7) the terms of the grant and the courses of study for which grants are available must meet all other requirements of section 117 and must be consistent with the disinterested purpose of education for personal benefit rather than for the benefit of the employer or the foundation.

[110] Rev. Proc. 80-39, 1980-2 C.B. 772.

or fellowship grants to the same group of eligible employees or employees' children, the percentage tests applicable to the loan program apply to the total number of individuals receiving combined grants of scholarships, fellowships, and educational loans.[111]

Description of Proposal

The percentage limits set forth in Revenue Procedure 76-47 for grants to children of employees are increased to 35 percent of eligible applicants considered by the selection committee or 20 percent of those eligible for the grants. However, the higher percentage limits are available only if the private foundation meets the other requirements of the Revenue Procedure and demonstrates that the foundation provides a comparable number and aggregate amount of grants during the same grant-program year to individuals who are not such employees, children or dependents of such employees, or affiliated with the employer of such employees. The proposal does not amend the percentage limits for grants to employees, or the percentage limits of Revenue Procedure 80-39 relating to loan programs or programs which encompass both loans and grants.

Effective Date

Revenue Procedure 76-47 is to be amended effective for grants awarded after the date of enactment.

[111] *Id.*

J. Treatment of Certain Hospital Support Organizations in Determining Acquisition Indebtedness

Present Law

In general, income of a tax-exempt organization that is produced by debt-financed property is treated as unrelated business income in proportion to the acquisition indebtedness on the income-producing property. Acquisition indebtedness generally means the amount of unpaid indebtedness incurred by an organization to acquire or improve the property and indebtedness that would not have been incurred but for the acquisition or improvement of the property. However, under an exception, acquisition indebtedness does not include indebtedness incurred by certain qualified organizations to acquire or improve real property. Qualified organizations include pension trusts, educational institutions, and title-holding companies.

Description of Proposal

The proposal expands the exception to the definition of acquisition indebtedness in the case of a qualified hospital support organization. The exception applies to eligible indebtedness (or the qualified refinancing thereof) of the qualified hospital support organization.

A qualified hospital support organization is a supporting organization (under section 509(a)(3)) of a hospital that is an academic health center (under section 119(d)(4)(B)). The assets of the supporting organization have to meet certain requirements. First, more than half of the value of the organization's assets at any time since its organization (1) have to have been acquired, directly or indirectly, by testamentary gift or devise, and (2) have to consist of real property. In addition, the fair market value of the organization's real estate acquired by gift or devise has to exceed 25 percent of the fair market value of all investment assets held by the organization immediately prior to the time that the eligible indebtedness was incurred. These requirements have to be met each time eligible indebtedness was incurred or a qualified refinancing thereof occurs.

Eligible indebtedness means indebtedness secured by real property acquired directly or indirectly by gift or devise, the proceeds of which are used exclusively to acquire a leasehold interest in or to improve or repair the property. A qualified refinancing of eligible indebtedness occurs if the refinancing does not exceed the amount of refinanced eligible indebtedness immediately before the refinancing.

Effective Date

The proposal applies to indebtedness incurred after December 31, 2003.

IV. SOCIAL SERVICES BLOCK GRANT

Present Law

Social Services Block Grant Funding ("SSBG"), also known as "Title XX" (because it is Title XX of the Social Security Act), is a flexible funding stream, providing states with resources to support a variety of social services. SSBG funds can be used to assist the elderly and disabled so that they do not need to enter institutions, to prevent child and elder abuse, to provide child care, to promote and support adoption, and for several other services. There are certain specified limitations so that SSBG cannot fund most medical care, for example, or cash welfare payments. It is a mandatory capped entitlement, distributed by a population-based formula among the states.

States use SSBG in differing ways. Much of the funding supports local social service providers, including faith-related organizations, through contracts with state and local governments. Overall, in fiscal year 1999, SSBG spending was as follows: 13.4 percent for "prevention" and case management; 13 percent for day care; 12.4 percent for child and adult protective services; 10.9 percent for foster care; 7.4 percent for home-based services. There are several other categories in the expenditure data as well.

Prior to the 1996 welfare reform law, SSBG was funded at $2.8 billion. That legislation reduced SSBG to $2.38 billion, as part of achieving budgetary savings, and permitted states to transfer up to 10 percent of their new Temporary Assistance for Needy Families (TANF) welfare block grant allocations to SSBG. (Any transferred funds are required to be spent on behalf of families below 200 percent of poverty.) In 1998, as part of the TEA-21 highway legislation, SSBG funding as further reduced, declining to $1.7 billion for fiscal year 2001 and fiscal year 2002. The TANF transfer was further limited to 4.25 percent.

Description of Proposal

The proposal increases SSBG funding to $1.975 billion for fiscal year 2003 and $2.8 billion for fiscal year 2004. In addition, the TANF transfer limit is restored to 10 percent. These two measures provide additional resources to faith-related social service organizations. Finally, the Secretary of HHS is required to submit annual reports on SSBG expenditures to the Congress.

Effective Date

The proposal is effective for amounts made available for fiscal year 2003 and for amounts made available each fiscal year thereafter. The proposal requiring annual reports applies to such reports with respect to fiscal year 2002 and each fiscal year thereafter.

V. INDIVIDUAL DEVELOPMENT ACCOUNTS

Present Law

Individual development accounts were first authorized by the Personal Work and Responsibility Act of 1996. In 1998, the Assets for Independence Act established a five-year $125 million demonstration program to permit certain eligible individuals to open and make contributions to an individual development account. Contributions by an individual to an individual development account do not receive a tax preference but are matched by contributions from a State program, a participating nonprofit organization, or other "qualified entity." The IRS has ruled that matching contributions by a qualified entity are a gift and not taxable to the account owner.[112] The qualified entity chooses a matching rate, which must be between 50 and 400 percent. Withdrawals from individual development accounts can be made for certain higher education expenses, a first home purchase, or small-business capitalization expenses. Matching contributions (and earnings thereon) typically are held separately from the individuals' contributions (and earnings thereon) and must be paid directly to a mortgage provider, university, or business capitalization account at a financial institution. The Department of Health and Human Services administers the individual development account program.

Description of Proposal

The proposal provides for a nonrefundable tax credit for an eligible entity (i.e., a qualified financial institution) that has an individual development account program in a taxable year. The tax credit equals the amount of matching contributions made by the eligible entity under the program (up to $500 per taxable year) plus $50 for each individual development account maintained during the taxable year under the program. Except in the first year that each account is open, the $50 credit is available only for accounts with a balance of more than $100 at year-end (including matching funds). The $50 credit is limited to seven years (the year the account is created and the six years immediately thereafter). The credit for matching funds is not allowed with respect to an individual's account if such individual has outstanding student loans, child support payments, or Federal tax liability. No deduction or other credit is available with respect to the amount of matching funds taken into account in determining the credit.

The credit applies with respect to the first 300,000 individual development accounts opened before January 1, 2012, and with respect to matching funds for participant contributions that are made after December 31, 2004, and before January 1, 2012. An account is considered open if at any time the balance in the account exceeds $100 (including matching amounts). The maximum amount of annual contributions to an individual development account by an otherwise eligible individual is limited to three times the maximum credit amount for matching contributions for such year. The individual development accounts will be available on the following basis: (1) a maximum of 100,000 accounts may be opened after December 31, 2004 and before January 1, 2008; (2) a second 100,000 accounts may be opened after December 31, 2007 and before January 1, 2010, if the entire 100,000 of authorized accounts are opened after December 31, 2004 and before January 1, 2008 and the Secretary of the Treasury determines that

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[112] Rev. Rul. 99-44, 1999-2 C.B. 549.

these accounts are being reasonably and responsibly administered;[113] and (3) a third 100,000 accounts may be opened after December 31, 2009 and before January 1, 2012 if the previous cohorts of 100,000 accounts have been opened under the schedule described above and the Secretary of the Treasury makes a four-part determination. Specifically, the Secretary will have to determine: (1) that all previously opened accounts have been reasonably and responsibly administered to date; (2) that the individual development account program has increased net savings of participants in the program; (3) whether participants in the individual development account program have increased Federal income tax liability and decreased utilization of Federal assistance programs (e.g., Temporary Assistance to Needy Families and Food Stamps) relative to similarly situated individuals that did not participate in the individual development account program; and (4) that the sum of the increased Federal tax liability and reduction of Federal assistance program benefits to participants in the individual development account program is greater than the cost of the individual development account program to the Federal government. If the Secretary finds that any of the four determinations has not been satisfied, the Congress will have the discretion to authorize the third 100,000 accounts after the Secretary makes his or her report to the Congress regarding the four determinations. The third 100,000 accounts must be equally divided among the States. For all accounts, the Secretary will take steps to encourage use of individual development accounts in rural areas.

Nonstudent U.S. citizens or lawful permanent residents between the ages of 18 and 60 (inclusive) who meet certain income requirements are eligible to open and contribute to an individual development account. The income limit for participation is modified adjusted gross income of $18,000 for single filers, $38,000 for joint filers, and $30,000 for head-of-household filers.[114] Eligibility in a taxable year generally is based on the previous year's modified adjusted gross income and circumstances (e.g., status as a student). Modified adjusted gross income is adjusted gross income plus certain items that are not includible in gross income. The items added are tax-exempt interest and the amounts otherwise excluded from gross income under Code sections 86, 893, 911, 931, and 933 (relating to the exclusion of certain social security and Tier 1 railroad retirement benefits; the exclusion of compensation of employees of foreign governments and international organizations; the exclusion of income of U.S. citizens or residents living abroad; the exclusion of income for residents of Guam, American Samoa, and the Northern Mariana Islands; and the exclusion of income for residents of Puerto Rico). The income limits are adjusted for inflation after 2003. These amounts are rounded to the nearest multiple of 50 dollars.

Under the proposal, an individual development account must: (1) be owned by the eligible individual for whom the account was established; (2) consist only of cash contributions; (3) be held by a person authorized to be a trustee of any individual retirement account under

[113] If less than 100,000 accounts are opened before January 1, 2008, then the number of accounts that can be opened after December 31, 2007 and before January 1, 2010 will be reduced to the lesser of 75,000 accounts or three times the number of accounts opened before January 1, 2007.

[114] Married taxpayers filing separate returns are not eligible to open an IDA or to receive matching funds for an IDA that is already open.

section 408(a)(2); and (4) not commingle account assets with other property (except in a common trust fund or common investment fund). These requirements must be reflected in the written governing instrument creating the account. The entity establishing the program is required to maintain separate accounts for the individual's contributions (and earnings thereon) and for matching funds and earnings thereon (a "parallel account").

Contributions to individual development accounts by individuals are not deductible and earnings thereon are taxable to the account holder. Matching contributions and earnings thereon are not taxable to the account holder. Any amount (including earnings) in an individual development account and matching contributions are disregarded for purposes of any means-tested Federal programs.

The proposal permits individuals to withdraw amounts from an individual development account for qualified expenses of the account owner, owner's spouse, or dependents as well as for nonqualified expenses, subject to certain restrictions. Qualified expenses include qualified: (1) higher education expenses (as generally defined in section 529(e)(3)); (2) first-time homebuyer costs (as generally provided in section 72 (t)(8)); (3) business capitalization or expansion costs (expenditures made pursuant to a business plan that has been approved by the financial institution); (4) rollovers of the balance of the account (including the parallel account) to another individual development account for the benefit of the same owner; and (5) final distributions in the case of a deceased account owner. Withdrawals for qualified expenses must be made from funds that have been in the account for at least one year and must be paid directly to the unrelated third party to whom the amount is due, except in the case of expenses under a qualified business plan, rollover, or final distribution. Such withdrawals generally are not permitted until the account owner completes a financial education course offered by a qualified financial institution. The Secretary of the Treasury (the "Secretary") is required to establish minimum standards for such courses. Withdrawals for nonqualified expenses may result in the account owner's forfeiture of matching funds. The amount of the forfeiture is the lesser of: (1) an amount equal to the nonqualified withdrawal; or (2) the excess of the amount in the parallel account (excluding earnings on matching funds) over the amount remaining in the individual development account after the nonqualified withdrawal. If the individual development account (or a portion thereof) is pledged as security for a loan, then the portion so used will be treated as a nonqualified withdrawal and will result in the loss of an equal amount of matching funds from the parallel account. At age 65, an individual may withdraw the balance of his or her individual development account for nonqualified purposes without losing matching amounts.

The qualified entity administering the individual development account program generally is required to make quarterly payments of matching funds to a parallel account on a dollar-for-dollar basis for the first $500 contributed by the account owner in a taxable year. Matching funds also may be provided by State, local, or private sources. Balances of the individual development account and parallel account must be reported annually to the account owner. If an account owner ceases to meet eligibility requirements, matching funds generally may not be contributed during the period of ineligibility. Any amount withdrawn from a parallel account is not includible in an eligible individual's gross income or the account sponsor's gross income.

Qualified entities administering a qualified program are required to report to the Secretary that the program is administered in accordance with legal requirements. If the

Secretary determines that the program was not so operated, the Secretary would have the power to terminate the program. Qualified entities also are required to report annually to the Secretary information about: (1) the number of individuals making contributions to individual development accounts; (2) the amounts contributed by such individuals; (3) the amount of matching funds contributed; (4) the amount of funds withdrawn and for what purpose; (5) balance information; and (6) any other information that the Secretary deems necessary. The fiduciary requirements of Title 12 of the United States Code with respect to insured depository institutions and insured credit unions (as defined therein) continue to apply to those financial institutions participating in the individual development account program. Qualified entities are prohibited from charging any fees with regard to the individual development accounts.

The Secretary is authorized to prescribe necessary regulations, including rules to permit individual development account program sponsors to verify eligibility of individuals seeking to open accounts and rules to allow a financial institution (e.g., a tax-exempt credit union) to transfer those credits to another taxpayer. The Secretary also is authorized to provide rules to recapture credits claimed with respect to individuals who forfeit matching funds.

The Secretary must submit annual reports to Congress on the status of the qualified individual account program.

Effective Date

The proposal is effective for taxable years ending after December 31, 2004, and beginning before January 1, 2012.

VI. AUTHORIZATION OF APPROPRIATIONS

Description of Proposal

The proposal authorizes to be appropriated to the Secretary of the Treasury $80 million for each fiscal year to carry out the administration of exempt organizations by the IRS.

The proposal authorizes to be appropriated to the Secretary of the Treasury $3 million to carry out the provisions of Public Laws 106-230 and 107-276, relating to section 527.

VII. REVENUE RAISING PROPOSALS

A. Provisions Designed to Curtail Tax Shelters

1. Clarification of the economic substance doctrine

<u>Present Law</u>

<u>In general</u>

The Code provides specific rules regarding the computation of taxable income, including the amount, timing, source, and character of items of income, gain, loss and deduction. These rules are designed to provide for the computation of taxable income in a manner that provides for a degree of specificity to both taxpayers and the government. Taxpayers generally may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.

In addition to the statutory provisions, courts have developed several doctrines that can be applied to deny the tax benefits of tax motivated transactions, notwithstanding that the transaction may satisfy the literal requirements of a specific tax provision. The common-law doctrines are not entirely distinguishable, and their application to a given set of facts is often blurred by the courts and the IRS. Although these doctrines serve an important role in the administration of the tax system, invocation of these doctrines can be seen as at odds with an objective, "rule-based" system of taxation. Nonetheless, courts have applied the doctrines to deny tax benefits arising from certain transactions.[115]

A common-law doctrine applied with increasing frequency is the "economic substance" doctrine. In general, this doctrine denies tax benefits arising from transactions that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax.[116]

<u>Economic substance doctrine</u>

Courts generally deny claimed tax benefits if the transaction that gives rise to those benefits lacks economic substance independent of tax considerations -- notwithstanding that the purported activity actually occurred. The tax court has described the doctrine as follows:

> The tax law . . . requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction.

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[115] *See, e.g., ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), *aff'g* 73 T.C.M. (CCH) 2189 (1997), *cert. denied* 526 U.S. 1017 (1999).

[116] Closely related doctrines also applied by the courts (sometimes interchangeable with the economic substance doctrine) include the "sham transaction doctrine" and the "business purpose doctrine". *See, e.g., Knetsch v. United States*, 364 U.S. 361 (1960) (denying interest deductions on a "sham transaction" whose only purpose was to create the deductions).

The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings.[117]

Business purpose doctrine

Another common law doctrine that overlays and is often considered together with (if not part and parcel of) the economic substance doctrine is the business purpose doctrine. The business purpose test is a subjective inquiry into the motives of the taxpayer -- that is, whether the taxpayer intended the transaction to serve some useful non-tax purpose. In making this determination, some courts have bifurcated a transaction in which independent activities with non-tax objectives have been combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.[118]

Application by the courts

Elements of the doctrine

There is a lack of uniformity regarding the proper application of the economic substance doctrine. Some courts apply a conjunctive test that requires a taxpayer to establish the presence of both economic substance (i.e., the objective component) and business purpose (i.e., the subjective component) in order for the transaction to sustain court scrutiny.[119] A narrower approach used by some courts is to invoke the economic substance doctrine only after a determination that the transaction lacks both a business purpose and economic substance (i.e., the existence of either a business purpose or economic substance would be sufficient to respect the transaction).[120] A third approach regards economic substance and business purpose as "simply

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[117] *ACM Partnership v. Commissioner*, 73 T.C.M. at 2215.

[118] *ACM Partnership v. Commissioner*, 157 F.3d at 256 n.48.

[119] *See, e.g., Pasternak v. Commissioner*, 990 F.2d 893, 898 (6th Cir. 1993) ("The threshold question is whether the transaction has economic substance. If the answer is yes, the question becomes whether the taxpayer was motivated by profit to participate in the transaction.")

[120] *See, e.g., Rice's Toyota World v. Commissioner*, 752 F.2d 89, 91-92 (4th Cir. 1985) ("To treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and, second, that the transaction has no economic substance because no reasonable possibility of a profit exists."); *IES Industries v. United States*, 253 F.3d 350, 358 (8th Cir. 2001) ("In determining whether a transaction is a sham for tax purposes [under the Eighth Circuit test], a transaction will be characterized as a sham if it is not motivated by any economic purpose out of tax considerations (the business purpose test), and if it is without economic substance because no real potential for profit exists" (the economic substance test).") As noted earlier, the economic substance doctrine and the sham transaction doctrine are similar and sometimes are applied interchangeably. For a more detailed discussion of the sham transaction doctrine, *see, e.g.*, Joint Committee on

more precise factors to consider" in determining whether a transaction has any practical economic effects other than the creation of tax benefits.[121]

Profit potential

There also is a lack of uniformity regarding the necessity and level of profit potential necessary to establish economic substance. Since the time of *Gregory*, several courts have denied tax benefits on the grounds that the subject transactions lacked profit potential.[122] In addition, some courts have applied the economic substance doctrine to disallow tax benefits in transactions in which a taxpayer was exposed to risk and the transaction had a profit potential, but the court concluded that the economic risks and profit potential were insignificant when compared to the tax benefits.[123] Under this analysis, the taxpayer's profit potential must be more than nominal. Conversely, other courts view the application of the economic substance doctrine as requiring an objective determination of whether a "reasonable possibility of profit" from the transaction existed apart from the tax benefits.[124] In these cases, in assessing whether a reasonable possibility of profit exists, it is sufficient if there is a nominal amount of pre-tax profit as measured against expected net tax benefits.

Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (including Provisions Relating to Corporate Tax Shelters)* (JCS-3-99) at 182.

[121] *See, e.g., ACM Partnership v. Commissioner,* 157 F.3d at 247; *James v. Commissioner,* 899 F.2d 905, 908 (10th Cir. 1995); *Sacks v. Commissioner,* 69 F.3d 982, 985 (9th Cir. 1995) ("Instead, the consideration of business purpose and economic substance are simply more precise factors to consider . . ..We have repeatedly and carefully noted that this formulation cannot be used as a 'rigid two-step analysis'.").

[122] *See, e.g., Knetsch*, 364 U.S. at 361; *Goldstein v. Commissioner*, 364 F.2d 734 (2d Cir. 1966) (holding that an unprofitable, leveraged acquisition of Treasury bills, and accompanying prepaid interest deduction, lacked economic substance); *Ginsburg v. Commissioner*, 35 T.C.M. (CCH) 860 (1976) (holding that a leveraged cattle-breeding program lacked economic substance).

[123] *See, e.g., Goldstein v. Commissioner,* 364 F.2d at 739-40 (disallowing deduction even though taxpayer had a possibility of small gain or loss by owning Treasury bills); *Sheldon v. Commissioner*, 94 T.C. 738, 768 (1990) (stating, "potential for gain . . . is infinitesimally nominal and vastly insignificant when considered in comparison with the claimed deductions").

[124] *See, e.g., Rice's Toyota World v. Commissioner*, 752 F.2d at 94 (the economic substance inquiry requires an objective determination of whether a reasonable possibility of profit from the transaction existed apart from tax benefits); *Compaq Computer Corp. v. Commissioner,* 277 F.3d at 781 (applied the same test, *citing Rice's Toyota World*); *IES Industries v. United States*, 253 F.3d at 354 (the application of the objective economic substance test involves determining whether there was a "reasonable possibility of profit . . . apart from tax benefits.").

Description of Proposal

In general

The proposal clarifies and enhances the application of the economic substance doctrine. The proposal provides that a transaction has economic substance (and thus satisfies the economic substance doctrine) only if the taxpayer establishes that (1) the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and (2) the taxpayer has a substantial non-tax purpose for entering into such transaction and the transaction is a reasonable means of accomplishing such purpose.[125]

Conjunctive analysis

The proposal clarifies that the economic substance doctrine involves a conjunctive analysis -- there must be an objective inquiry regarding the effects of the transaction on the taxpayer's economic position, as well as a subjective inquiry regarding the taxpayer's motives for engaging in the transaction. Under the proposal, a transaction must satisfy both tests -- i.e., it must change in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and the taxpayer must have a substantial non-tax purpose for entering into such transaction (and the transaction is a reasonable means of accomplishing such purpose) -- in order to satisfy the economic substance doctrine. This clarification eliminates the disparity that exists among the circuits regarding the application of the doctrine, and modifies its application in those circuits in which either a change in economic position or a non-tax business purpose (without having both) is sufficient to satisfy the economic substance doctrine.

Non-tax business purpose

The proposal provides that a taxpayer's non-tax purpose for entering into a transaction (the second prong in the analysis) must be "substantial," and that the transaction must be "a reasonable means" of accomplishing such purpose. Under this formulation, the non-tax purpose for the transaction must bear a reasonable relationship to the taxpayer's normal business operations or investment activities.[126]

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[125] If the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine as defined in this proposal.

[126] *See,* Martin McMahon Jr., *Economic Substance, Purposive Activity, and Corporate Tax Shelters,* 94 Tax Notes 1017, 1023 (Feb. 25, 2002) (advocates "confining the most rigorous application of business purpose, economic substance, and purposive activity tests to transactions outside the ordinary course of the taxpayer's business -- those transactions that do not appear to contribute to any business activity or objective that the taxpayer may have had apart from tax planning but are merely loss generators."); Mark P. Gergen, *The Common Knowledge of Tax Abuse,* 54 SMU L. Rev. 131, 140 (Winter 2001) ("The message is that you can pick up tax gold if you find it in the street while going about your business, but you cannot go hunting for it.").

In determining whether a taxpayer has a substantial non-tax business purpose, it is intended that an objective of achieving a favorable accounting treatment for financial reporting purposes will not be treated as having a substantial non-tax purpose.[127] Furthermore, a transaction that is expected to increase financial accounting income as a result of generating tax deductions or losses without a corresponding financial accounting charge (i.e., a permanent book-tax difference)[128] should not be considered to have a substantial non-tax purpose unless a substantial non-tax purpose exists apart from the financial accounting benefits.[129]

By requiring that a transaction be a "reasonable means" of accomplishing its non-tax purpose, the proposal broadens the ability of the courts to bifurcate a transaction in which independent activities with non-tax objectives are combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.

Profit potential

Under the proposal, a taxpayer may rely on factors other than profit potential to demonstrate that a transaction results in a meaningful change in the taxpayer's economic position; the proposal merely sets forth a minimum threshold of profit potential if that test is relied on to demonstrate a meaningful change in economic position. If a taxpayer relies on a profit potential, however, the present value of the reasonably expected pre-tax profit must be substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.[130] Moreover, the profit potential must exceed a risk-free rate of

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[127] However, if the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, such tax benefits should not be disallowed solely because the transaction results in a favorable accounting treatment. An example is the repealed foreign sales corporation rules.

[128] This includes tax deductions or losses that are anticipated to be recognized in a period subsequent to the period the financial accounting benefit is recognized. For example, FAS 109 in some cases permits the recognition of financial accounting benefits prior to the period in which the tax benefits are recognized for income tax purposes.

[129] Claiming that a financial accounting benefit constitutes a substantial non-tax purpose fails to consider the origin of the accounting benefit (i.e., reduction of taxes) and significantly diminishes the purpose for having a substantial non-tax purpose requirement. *See, e.g., American Electric Power, Inc. v. U.S.,* 136 F. Supp. 2d 762, 791-92 (S.D. Ohio, 2001) ("AEP's intended use of the cash flows generated by the [corporate-owned life insurance] plan is irrelevant to the subjective prong of the economic substance analysis. If a legitimate business purpose for the use of the tax savings 'were sufficient to breathe substance into a transaction whose only purpose was to reduce taxes, [then] every sham tax-shelter device might succeed,'" *citing Winn-Dixie v. Commissioner,* 113 T.C. 254, 287 (1999)).

[130] Thus, a "reasonable possibility of profit" will not be sufficient to establish that a transaction has economic substance.

return. In addition, in determining pre-tax profit, fees and other transaction expenses and foreign taxes are treated as expenses.

In applying the profit test to the lessor of tangible property, certain deductions and other applicable tax credits (such as the rehabilitation tax credit and the low income housing tax credit) are not taken into account in measuring tax benefits. Thus, a traditional leveraged lease is not affected by the bill to the extent it meets the present law standards.

Transactions with tax-indifferent parties

The proposal also provides special rules for transactions with tax-indifferent parties. For this purpose, a tax-indifferent party means any person or entity not subject to Federal income tax, or any person to whom an item would have no substantial impact on its income tax liability. Under these rules, the form of a financing transaction will not be respected if the present value of the tax deductions to be claimed is substantially in excess of the present value of the anticipated economic returns to the lender. Also, the form of a transaction with a tax-indifferent party will not be respected if it results in an allocation of income or gain to the tax-indifferent party in excess of the tax-indifferent party's economic gain or income or if the transaction results in the shifting of basis on account of overstating the income or gain of the tax-indifferent party.

Other rules

The Secretary may prescribe regulations which provide (1) exemptions from the application of this proposal, and (2) other rules as may be necessary or appropriate to carry out the purposes of the proposal.

No inference is intended as to the proper application of the economic substance doctrine under present law. In addition, except with respect to the economic substance doctrine, the proposal shall not be construed as altering or supplanting any other common law doctrine (including the sham transaction doctrine), and this proposal shall be construed as being additive to any such other doctrine.

Effective Date

The proposal applies to transactions entered into after the date of enactment.

2. Penalty for failure to disclose reportable transactions

Present Law

Regulations under section 6011 require a taxpayer to disclose with its tax return certain information with respect to each "reportable transaction" in which the taxpayer participates.[131]

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[131] On October 17, 2002, Treasury Department and the IRS released new temporary and proposed regulations regarding the disclosure of reportable transactions. The regulations are effective for transactions entered into on or after January 1, 2003. Subsequent to the issuance of the new regulations, the IRS announced that, in light of the numerous comments received

There are six categories of reportable transactions. The first category is any transaction that is the same as (or substantially similar to)[132] a transaction that is specified by the Treasury Department as a tax avoidance transaction whose tax benefits are subject to disallowance under present law (referred to as a "listed transaction").[133]

The second category is any transaction that is offered under conditions of confidentiality. If a taxpayer's disclosure of the structure or tax aspects of the transaction is limited in any way by an express or implied understanding or agreement with or for the benefit of any person who makes or provides a statement, oral or written, as to the potential tax consequences that may result from the transaction, it is considered offered under conditions of confidentiality (whether or not the understanding is legally binding).[134]

The third category of reportable transaction is any transaction for which the taxpayer has obtained or been provided with contractual protection against the possibility that part or all of the intended tax consequences from the transaction will not be sustained. Such protection can include recission rights, the right to a refund of fees, contingent fees, insurance protection with respect to the tax treatment, or a tax indemnity or similar agreement.[135]

The fourth category of reportable transactions relates to any transaction resulting in, or that is reasonably expected to result in, a taxpayer claiming a loss (under section 165) of at least (1) $10 million in any single year or $20 million in any combination of years by a corporate taxpayer; (2) $5 million in any single year or $10 million in any combination of years by a partnership or S corporation; (3) $2 million in any single year or $4 million in any combination of years by an individual or trust; or (4) $50,000 in any single year for individuals or trusts if the loss arises with respect to foreign currency translation losses.[136]

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regarding the new regulations, the revised regulations under section 6011 will permit taxpayers who entered into transactions on or after January 1, 2003 (and before the filing date of the revised regulations) to elect to apply the revised regulations. Notice 2003-11, 2003-6 I.R.B. 1 (January 17, 2003).

The discussion of present law refers to the new regulations. The rules that apply with respect to transactions entered into on or before December 31, 2002, are contained in Treas. Reg. sec. 1.6011-4T in effect prior to January 1, 2003.

[132] The regulations clarify that the term "substantially similar" includes any transaction that is expected to obtain the same or similar types of tax benefits and that is either factually similar or based on the same or similar tax strategy. Also, the term must be broadly construed in favor of disclosureTemp. Treas. Reg. sec. 1-6011-4T(c)(4).

[133] Temp. Treas. Reg. sec. 1.6011-4T(b)(2).

[134] Temp. Treas. Reg. sec. 1.6011-4T(b)(3).

[135] Temp. Treas. Reg. sec. 1.6011-4T(b)(4).

[136] Temp. Treas. Reg. sec. 1.6011-4T(b)(5).

The fifth category of reportable transactions refers to any transaction done by certain taxpayers[137] in which the tax treatment of the transaction differs (or is expected to differ) by more than $10 million from its treatment for book purposes (using generally accepted accounting principles) in any year.[138]

The final category of reportable transactions is any transaction that results in a tax credit exceeding $250,000 (including a foreign tax credit) if the taxpayer holds the underlying asset for less than 45 days.[139]

Under present law, there is no specific penalty for failing to disclose a reportable transaction; however, such a failure may jeopardize a taxpayer's ability to claim that any income tax understatement attributable to such undisclosed transaction is due to reasonable cause, and that the taxpayer acted in good faith.[140]

Description of Proposal

In general

The proposal creates a new penalty for any person who fails to include with any return or statement any required information with respect to a reportable transaction. The new penalty applies without regard to whether the transaction ultimately results in an understatement of tax, and applies in addition to any accuracy-related penalty that may be imposed.

Transactions to be disclosed

The proposal does not define the terms "listed transaction"[141] or "reportable transaction," nor does the proposal explain the type of information that must be disclosed in order to avoid the

[137] The significant book-tax category applies only to taxpayers that are reporting companies under the Securities Exchange Act of 1934 or business entities that have $100 million or more in gross assets.

[138] Temp. Treas. Reg. sec. 1.6011-4T(b)(6). The regulations exempt 13 types of transactions from the book-tax reportable transaction category. *See* Temp. Treas. Reg. sec. 1.6011-4T(b)(6)(iii)(A)-(M).

[139] Temp. Treas. Reg. sec. 1.6011-4T(b)(7).

[140] Section 6664(c) provides that a taxpayer can avoid the imposition of a section 6662 accuracy-related penalty in cases where the taxpayer can demonstrate that there was reasonable cause for the underpayment and that the taxpayer acted in good faith. On December 31, 2002, the Treasury Department and IRS issued proposed regulations under sections 6662 and 6664 (REG-126016-01) that limit the defenses available to the imposition of an accuracy-related penalty in connection with a reportable transaction when the transaction is not disclosed.

[141] The proposal states that, except as provided in regulations, a listed transaction means a reportable transaction, which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section

imposition of a penalty. Rather, the proposal authorizes the Treasury Department to define a "listed transaction" and a "reportable transaction" under section 6011.

Penalty rate

The penalty for failing to disclose a reportable transaction is $50,000. The amount is increased to $100,000 if the failure is with respect to a listed transaction. For large entities and high net worth individuals, the penalty amount is doubled (i.e., $100,000 for a reportable transaction and $200,000 for a listed transaction). The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded or abated only if: (1) the taxpayer on whom the penalty is imposed has a history of complying with the Federal tax laws, (2) it is shown that the violation is due to an unintentional mistake of fact, (3) imposing the penalty would be against equity and good conscience, and (4) rescinding the penalty would promote compliance with the tax laws and effective tax administration. The authority to rescind the penalty can only be exercised by the IRS Commissioner personally or the head of the Office of Tax Shelter Analysis. Thus, the penalty cannot be rescinded by a revenue agent, an appeals officer, or any other IRS personnel. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no taxpayer right to appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this proposal and the reasons for the rescission.

A "large entity" is defined as any entity with gross receipts in excess of $10 million in the year of the transaction or in the preceding year. A "high net worth individual" is defined as any individual whose net worth exceeds $2 million, based on the fair market value of the individual's assets and liabilities immediately before entering into the transaction.

A public entity that is required to pay a penalty for failing to disclose a listed transaction (or is subject to an understatement penalty attributable to a non-disclosed listed transaction, a non-disclosed reportable avoidance transaction, or a transaction that lacks economic substance[142]) must disclose the imposition of the penalty in reports to the Securities and Exchange Commission for such period as the Secretary shall specify. The proposal applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and treats any failure to disclose a transaction in such reports as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports

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6011. For this purpose, it is expected that the definition of "substantially similar" will be the definition used in Temp. Treas. Reg. sec. 1.6011-4T(b)(2). However, the Secretary may modify this definition (as well as the definitions of "listed transaction" and "reportable transactions") as appropriate.

[142] These categories of transactions are described in greater detail below in connection with the proposals modifying the accuracy-related penalty for listed and certain reportable transactions and a penalty for understatements attributable to transactions that lack economic substance.

to the Securities and Exchange Commission once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Effective Date

The proposal is effective for returns and statements the due date for which is after the date of enactment.

3. Modifications to the accuracy-related penalties for listed transactions and reportable transactions having a significant tax avoidance purpose

Present Law

The accuracy-related penalty applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of corporations), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[143] The amount of any understatement generally is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.[144]

Special rules apply with respect to tax shelters.[145] For understatements by non-corporate taxpayers attributable to tax shelters, the penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for the position, the taxpayer reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the penalty is unavailable to corporate tax shelters.

The understatement penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[146] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] . . . unambiguously

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[143] Sec. 6662.

[144] Sec. 6662(d)(2)(B).

[145] Sec. 6662(d)(2)(C).

[146] Sec. 6664(c).

concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[147]

Description of Proposal

In general

The proposal modifies the present-law accuracy related penalty by replacing the rules applicable to tax shelters with a new accuracy-related penalty that applies to listed transactions and reportable transactions with a significant tax avoidance purpose (hereinafter referred to as a "reportable avoidance transaction").[148] The penalty rate and defenses available to avoid the penalty vary depending on the category of the transaction (i.e., listed or reportable avoidance transaction) and whether the transaction was adequately disclosed.

Disclosed transactions

In general, a 20-percent accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction. The only exception to the penalty is if the taxpayer satisfies a more stringent reasonable cause and good faith exception (hereinafter referred to as the "strengthened reasonable cause exception"), which is described below. The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

Undisclosed transactions

If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty applies), and the taxpayer is subject to an increased penalty rate equal to 30 percent of the understatement.

In addition, a public entity that is required to pay the 30 percent penalty must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Once the 30 percent penalty has been included in the Revenue Agent Report, the penalty cannot be compromised for purposes of a settlement without approval of the Commissioner

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[147] Treas. Reg. sec. 1.6662-4(g)(4)(i)(B); Treas. Reg. sec. 1.6664-4(c).

[148] The terms "reportable transaction" and "listed transaction" have the same meanings as previously described in connection with the penalty for failing to disclose reportable transactions.

personally or the head of the Office of Tax Shelter Analysis. Furthermore, the IRS is required to submit an annual report to Congress summarizing the application of this penalty and providing a description of each penalty compromised under this proposal and the reasons for the compromise.

Determination of the understatement amount

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this proposal, the amount of the understatement is determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return) [149], and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.

Strengthened reasonable cause exception

A penalty is not imposed under the proposal with respect to any portion of an understatement if it shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011,[150] (2) there is or was substantial authority for such treatment, and (3) the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed, and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised.

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor," or (2) is a "disqualified opinion."

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[149] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income.

[150] *See* the previous discussion regarding the penalty for failing to disclose a reportable transaction.

Disqualified tax advisor

A disqualified tax advisor is any advisor who (1) is a material advisor[151] and who participates in the organization, management, promotion or sale of the transaction or is related (within the meaning of section 267 or 707) to any person who so participates, (2) is compensated directly or indirectly[152] by a material advisor with respect to the transaction, (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained, or (4) as determined under regulations prescribed by the Secretary, has a continuing financial interest with respect to the transaction.

Organization, management, promotion or sale of a transaction

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents (1) establishing a structure used in connection with the transaction (such as a partnership agreement), (2) describing the transaction (such as an offering memorandum or other statement describing the transaction), or (3) relating to the registration of the transaction with any federal, state or local government body.[153] Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

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[151] The term "material advisor" (defined below in connection with the new information filing requirements for material advisors) means any person who provides any material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons ($250,000 in any other case).

[152] This situation could arise, for example, when an advisor has an arrangement or understanding (oral or written) with an organizer, manager, or promoter of a reportable transaction that such party will recommend or refer potential participants to the advisor for an opinion regarding the tax treatment of the transaction.

[153] An advisor should not be treated as participating in the organization of a transaction if the advisor's only involvement with respect to the organization of the transaction is the rendering of an opinion regarding the tax consequences of such transaction. However, such an advisor may be a "disqualified tax advisor" with respect to the transaction if the advisor participates in the management, promotion or sale of the transaction (or if the advisor is compensated by a material advisor, has a fee arrangement that is contingent on the tax benefits of the transaction, or as determined by the Secretary, has a continuing financial interest with respect to the transaction).

Disqualified opinion

An opinion may not be relied upon if the opinion (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events), (2) unreasonably relies upon representations, statements, finding or agreements of the taxpayer or any other person, (3) does not identify and consider all relevant facts, or (4) fails to meet any other requirement prescribed by the Secretary.

Coordination with other penalties

Any understatement to which a penalty is imposed under this proposal is not subject to the accuracy-related penalty under section 6662. However, such understatement is included for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1).

The penalty imposed under this proposal shall not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

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

4. Penalty for understatements from transactions lacking economic substance

Present Law

An accuracy-related penalty applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of corporations), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[154] The amount of any understatement is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.

Special rules apply with respect to tax shelters.[155] For understatements by non-corporate taxpayers attributable to tax shelters, the penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for the position, the taxpayer reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the penalty is unavailable to corporate tax shelters.

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[154] Sec. 6662.

[155] Sec. 6662(d)(2)(C).

The penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[156] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] . . . unambiguously concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[157]

Description of Proposal

The proposal imposes a penalty for an understatement attributable to any transaction that lacks economic substance (referred to in the statute as a "non-economic substance transaction understatement").[158] The penalty rate is 40 percent (reduced to 20 percent if the taxpayer adequately discloses the relevant facts in accordance with regulations prescribed under section 6011). No exceptions (including the reasonable cause or rescission rules) to the penalty would be available under the proposal (i.e., the penalty is a strict-liability penalty).

A "non-economic substance transaction" means any transaction if (1) the transaction lacks economic substance (as defined in the earlier proposal regarding the economic substance doctrine),[159] (2) the transaction was not respected under the rules relating to transactions with tax-indifferent parties (as described in the earlier proposal regarding the economic substance doctrine),[160] or (3) any similar rule of law. For this purpose, a similar rule of law would include, for example, an understatement attributable to a transaction that is determined to be a sham transaction.

For purposes of this proposal, the calculation of an "understatement" is made in the same manner as in the separate proposal relating to accuracy-related penalties for listed and reportable avoidance transactions (new sec. 6662A). Thus, the amount of the understatement under this proposal would be determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other

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[156] Sec. 6664(c).

[157] Treas. Reg. sec. 1.6662-4(g)(4)(i)(B); Treas. Reg. sec. 1.6664-4(c).

[158] Thus, unlike the new accuracy-related penalty under section 6662A (which applies only to listed and reportable avoidance transactions), the new penalty under this proposal applies to any transaction that lacks economic substance.

[159] The proposal provides that a transaction has economic substance only if (1) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (2) the transaction has a substantial non-tax purpose for entering into such transaction and is a reasonable means of accomplishing such purpose.

[160] The proposal provides that the form of a transaction that involves a tax-indifferent party will not be respected in certain circumstances.

items on the tax return),[161] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item. In essence, the penalty will apply to the amount of any understatement attributable solely to a non-economic substance transaction.

Except as provided in regulations, the taxpayer's treatment of an item will not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.

A public entity that is required to pay a penalty under this proposal (regardless of whether the transaction was disclosed) must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Once a penalty (regardless of whether the transaction was disclosed) has been included in the Revenue Agent Report, the penalty cannot be compromised for purposes of a settlement without approval of the Commissioner personally or the head of the Office of Tax Shelter Analysis. Furthermore, the IRS is required to submit an annual report to Congress summarizing the application of this penalty and providing a description of each penalty compromised under this proposal and the reasons for the compromise.

Any understatement to which a penalty is imposed under this proposal will not be subject to the accuracy-related penalty under section 6662 or under new 6662A (accuracy-related penalties for listed and reportable avoidance transactions). However, an understatement under this proposal would be taken into account for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1). The penalty imposed under this proposal will not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

The proposal applies to transactions after the date of enactment.

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[161] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses that would (without regard to section 1211) be allowed for such year, would be treated as an increase in taxable income.

5. Modifications to the substantial understatement penalty

Present Law

Definition of substantial understatement

An accuracy-related penalty equal to 20 percent applies to any substantial understatement of tax. A "substantial understatement" exists if the correct income tax liability for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of most corporations).[162]

Reduction of understatement for certain positions

For purposes of determining whether a substantial understatement penalty applies, the amount of any understatement generally is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.[163]

The Secretary is required to publish annually in the Federal Register a list of positions for which the Secretary believes there is not substantial authority and which affect a significant number of taxpayers.[164]

Description of Proposal

Definition of substantial understatement

The proposal modifies the definition of "substantial" for corporate taxpayers. Under the proposal, a corporate taxpayer has a substantial understatement if the amount of the understatement for the taxable year exceeds the lesser of (1) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, $10,000), or (2) $10 million.

Reduction of understatement for certain positions

The proposal elevates the standard that a taxpayer must satisfy in order to reduce the amount of an understatement for undisclosed items. With respect to the treatment of an item whose facts are not adequately disclosed, a resulting understatement is reduced only if the taxpayer had a reasonable belief that the tax treatment was more likely than not the proper treatment. The proposal also authorizes (but does not require) the Secretary to publish a list of positions for which it believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper treatment (without regard to whether

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[162] Sec. 6662(a) and (d)(1)(A).

[163] Sec. 6662(d)(2)(B).

[164] Sec. 6662(d)(2)(D).

such positions affect a significant number of taxpayers). The list shall be published in the Federal Register or the Internal Revenue Bulletin.

Effective Date

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

6. Tax shelter exception to confidentiality privileges relating to taxpayer communications

Present Law

In general, a common law privilege of confidentiality exists for communications between an attorney and client with respect to the legal advice the attorney gives the client. The Code provides that, with respect to tax advice, the same common law protections of confidentiality that apply to a communication between a taxpayer and an attorney also apply to a communication between a taxpayer and a federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney. This rule is inapplicable to communications regarding corporate tax shelters.

Description of Proposal

The proposal modifies the rule relating to corporate tax shelters by making it applicable to all tax shelters, whether entered into by corporations, individuals, partnerships, tax-exempt entities, or any other entity. Accordingly, communications with respect to tax shelters are not subject to the confidentiality proposal of the Code that otherwise applies to a communication between a taxpayer and a federally authorized tax practitioner.

Effective Date

The proposal is effective with respect to communications made on or after the date of enactment.

7. Disclosure of reportable transactions by material advisors

Present Law

Registration of tax shelter arrangements

An organizer of a tax shelter is required to register the shelter with the Secretary not later than the day on which the shelter is first offered for sale.[165] A "tax shelter" means any investment with respect to which the tax shelter ratio[166] for any investor as of the close of any of

[165] Sec. 6111(a).

[166] The tax shelter ratio is, with respect to any year, the ratio that the aggregate amount of the deductions and 350 percent of the credits, which are represented to be potentially allowable to any investor, bears to the investment base (money plus basis of assets contributed) as of the close of the tax year.

the first five years ending after the investment is offered for sale may be greater than two to one and which is: (1) required to be registered under Federal or State securities laws, (2) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or State securities agency, or (3) a substantial investment (greater than $250,000 and at least five investors).[167]

Other promoted arrangements are treated as tax shelters for purposes of the registration requirement if: (1) a significant purpose of the arrangement is the avoidance or evasion of Federal income tax by a corporate participant; (2) the arrangement is offered under conditions of confidentiality; and (3) the promoter may receive fees in excess of $100,000 in the aggregate.[168]

A transaction has a "significant purpose of avoiding or evading Federal income tax" if the transaction: (1) is the same as or substantially similar to a "listed transaction,"[169] or (2) is structured to produce tax benefits that constitute an important part of the intended results of the arrangement and the promoter reasonably expects to present the arrangement to more than one taxpayer.[170] Certain exceptions are provided with respect to the second category of transactions.[171]

An arrangement is offered under conditions of confidentiality if: (1) an offeree has an understanding or agreement to limit the disclosure of the transaction or any significant tax features of the transaction; or (2) the promoter claims, knows, or has reason to know that a party other than the potential participant claims that the transaction (or any aspect of it) is proprietary to the promoter or any party other than the offeree, or is otherwise protected from disclosure or use.[172]

<u>**Failure to register tax shelter**</u>

The penalty for failing to timely register a tax shelter (or for filing false or incomplete information with respect to the tax shelter registration) generally is the greater of one percent of

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[167] Sec. 6111(c).

[168] Sec. 6111(d).

[169] Temp. Treas. Reg. sec. 301.6111-2T(b)(2).

[170] Temp. Treas. Reg. sec. 301.6111-2T(b)(3).

[171] Temp. Treas. Reg. sec. 301.6111-2T(b)(4).

[172] The regulations provide that the determination of whether an arrangement is offered under conditions of confidentiality is based on all the facts and circumstances surrounding the offer. If an offeree's disclosure of the structure or tax aspects of the transaction are limited in any way by an express or implied understanding or agreement with or for the benefit of a tax shelter promoter, an offer is considered made under conditions of confidentiality, whether or not such understanding or agreement is legally binding. Treas. Reg. sec. 301.6111-2T(c)(1).

the aggregate amount invested in the shelter or $500.[173] However, if the tax shelter involves an arrangement offered to a corporation under conditions of confidentiality, the penalty is the greater of $10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration. Intentional disregard of the requirement to register increases the penalty to 75 percent of the applicable fees.

Section 6707 also imposes (1) a $100 penalty on the promoter for each failure to furnish the investor with the required tax shelter identification number, and (2) a $250 penalty on the investor for each failure to include the tax shelter identification number on a return.

Description of Proposal

Disclosure of reportable transactions by material advisors

The proposal repeals the present law rules with respect to registration of tax shelters. Instead, the proposal requires each material advisor with respect to any reportable transaction (including listed transaction)[174] to timely file an information return with the Secretary (in such form and manner as the Secretary may prescribe). The return must be filed on such date as specified by the Secretary.

The information return will include (1) information identifying and describing the transaction, (2) information describing any potential tax benefits expected to result from the transaction, and (3) such other information as the Secretary may prescribe. It is expected that the Secretary may seek from the material advisor the same type of information that the Secretary may request from a taxpayer in connection with a reportable transaction.[175]

A "material advisor" means any person (1) who provides material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, or carrying out any reportable transaction, and (2) who directly or indirectly derives gross income in excess of $250,000 ($50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons) for such advice or assistance.

The Secretary may prescribe regulations which provide (1) that only one material advisor has to file an information return in cases in which two or more material advisors would otherwise be required to file information returns with respect to a particular reportable transaction, (2) exemptions from the requirements of this section, and (3) other rules as may be necessary or appropriate to carry out the purposes of this section (including, for example, rules regarding the aggregation of fees in appropriate circumstances).

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[173] Sec. 6707.

[174] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related proposals.

[175] *See* the previous discussion regarding the disclosure requirements under new section 6707A.

Penalty for failing to furnish information regarding reportable transactions

The proposal repeals the present law penalty for failure to register tax shelters. Instead, the proposal imposes a penalty on any material advisor who fails to file an information return, or who files a false or incomplete information return, with respect to a reportable transaction (including a listed transaction).[176] The amount of the penalty is $50,000. If the penalty is with respect to a listed transaction, the amount of the penalty is increased to the greater of (1) $200,000, or (2) 50 percent of the gross income of such person with respect to aid, assistance, or advice which is provided with respect to the reportable transaction before the date the information return that includes the transaction is filed. Intentional disregard by a material advisor of the requirement to disclose a reportable transaction increases the penalty to 75 percent of the gross income.

The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded or abated only in exceptional circumstances.[177] All or part of the penalty may be rescinded only if: (1) the material advisor on whom the penalty is imposed has a history of complying with the Federal tax laws, (2) it is shown that the violation is due to an unintentional mistake of fact, (3) imposing the penalty would be against equity and good conscience, and (4) rescinding the penalty would promote compliance with the tax laws and effective tax administration. The authority to rescind the penalty can only be exercised by the Commissioner personally or the head of the Office of Tax Shelter Analysis; this authority to rescind cannot otherwise be delegated by the Commissioner. Thus, the penalty cannot be rescinded by a revenue agent, an appeals officer, or other IRS personnel. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no right to appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this proposal and the reasons for the rescission.

Effective Date

The proposal requiring disclosure of reportable transactions by material advisors applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment.

The proposal imposing a penalty for failing to disclose reportable transactions applies to returns the due date for which is after the date of enactment.

[176] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related proposals.

[177] The Secretary's present-law authority to postpone certain tax-related deadlines because of Presidentially-declared disasters (sec. 7508A) will also encompass the authority to postpone the reporting deadlines established by the proposal.

8. Investor lists and modification of penalty for failure to maintain investor lists

Present Law

Investor lists

Any organizer or seller of a potentially abusive tax shelter must maintain a list identifying each person who was sold an interest in any such tax shelter with respect to which registration was required under section 6111 (even though the particular party may not have been subject to confidentiality restrictions).[178] Recently-issued temporary regulations under section 6112 contain elaborate rules regarding the list maintenance requirements.[179] The regulations apply to transactions that are potentially abusive tax shelters entered into, or acquired after, January 1, 2003.[180]

The temporary regulations, issued in October 2002, provide that a person is an organizer or seller of a potentially abusive tax shelter if the person is a material advisor with respect to that transaction.[181] A potentially abusive tax shelter is any transaction that (1) is required to be registered under section 6111, (2) is a listed transaction (as defined under the new temporary regulations under section 6011), or (3) any transaction that a potential material advisor knows or has reason to know, at the time the transaction is entered into, is a reportable transaction (as defined under the new temporary regulations under section 6011).[182]

The temporary regulations define an organizer or a seller of an interest with respect to a potentially abusive tax shelter if that person is a "material advisor." A material advisor is defined any person who (directly or indirectly) receives, or is expected to receive, a minimum fee of (1) $250,000 for a transaction that is a potentially abusive tax shelter if all participants are corporations, or (2) $50,000 for any other transaction that is a potentially abusive tax shelter.[183]

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[178] Sec. 6112.

[179] Temp. Treas. Reg. sec. 301-6112-1T.

[180] Subsequent to the issuance of the new regulations, the IRS announced that, in order to provide necessary clarification of the list maintenance regulations, the effective date will be changed to the date that revised regulations under section 6112 are filed. The delayed effective date, however, will not apply to listed transactions or transactions that are section 6111 shelters (as defined in Treas. Reg. sec. 301.6112-1T(b)(1)). Notice 2003-11, 2003-6 I.R.B. 1 (January 17, 2003).

[181] Temp. Treas. Reg. sec. 301.6112-1T(c)(1).

[182] Temp. Treas. Reg. sec. 301.6112-1T(b).

[183] Temp. Treas. Reg. sec. 301.6112-1T(c)(1) and (2).

The Secretary is required to prescribe regulations which provide that, in cases in which 2 or more persons are required to maintain the same list, only one person would be required to maintain the list.[184]

Penalties for failing to maintain investor lists

Under section 6708, the penalty for failing to maintain the list required under section 6112 is $50 for each name omitted from the list (with a maximum penalty of $100,000 per year).

Description of Proposal

Investor lists

Each material advisor[185] that is required to file an information return with respect to a reportable transaction (including a listed transaction)[186] is required to maintain a list that (1) identifies each person with respect to whom the advisor acted as a material advisor with respect to the reportable transaction, and (2) contains other information as may be required by the Secretary. In addition, the proposal authorizes (but does not require) the Secretary to prescribe regulations which provide that, in cases in which 2 or more persons are required to maintain the same list, only one person would be required to maintain the list.

Penalty for failing to maintain investor lists

The proposal modifies the penalty for failing to maintain the required list by making it a time-sensitive penalty. Thus, a material advisor who is required to maintain an investor list and who fails to make the list available upon request by the Secretary within 20 business days after the request will be subject to a $10,000 per day penalty. The penalty applies to a person who fails to maintain a list, maintains an incomplete list, or has in fact maintained a list but does not make the list available to the Secretary. The penalty can be waived if the failure to make the list available is due to reasonable cause.[187]

Effective Date

The proposal requiring a material advisor to maintain an investor list applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment.

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[184] Sec. 6112(c)(2).

[185] The term "material advisor" has the same meaning as when used in connection with the requirement to file an information return under section 6111.

[186] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related proposals.

[187] In no event will failure to maintain a list be considered reasonable cause for failing to make a list available to the Secretary.

The proposal imposing a penalty for failing to maintain investor lists applies to requests made after the date of enactment.

9. Actions to enjoin conduct with respect to tax shelters and reportable transactions

Present Law

The Code authorizes civil action to enjoin any person from promoting abusive tax shelters or aiding or abetting the understatement of tax liability.[188]

Description of Proposal

The proposal expands this rule so that injunctions may also be sought with respect to the requirements relating to the reporting of reportable transactions[189] and the keeping of lists of investors by material advisors.[190] Thus, under the proposal, an injunction may be sought against a material advisor to enjoin the advisor from (1) failing to file an information return with respect to a reportable transaction, or (2) failing to maintain, or to timely furnish upon written request by the Secretary, a list of investors with respect to each reportable transaction.

Effective Date

The proposal is effective on the day after the date of enactment.

10. Understatement of taxpayer's liability by income tax return preparer

Present Law

An income tax return preparer who prepares a return with respect to which there is an understatement of tax that is due to a position for which there was not a realistic possibility of being sustained on its merits and the position was not disclosed (or was frivolous) is liable for a penalty of $250, provided that the preparer knew or reasonably should have known of the position. An income tax return preparer who prepares a return and engages in specified willful or reckless conduct with respect to preparing such a return is liable for a penalty of $1,000.

Description of Proposal

The proposal alters the standards of conduct that must be met to avoid imposition of the first penalty. The proposal replaces the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position was more likely than not the proper treatment. The proposal also replaces the not frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

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[188] Sec. 7408.

[189] Sec. 6707, as amended by other proposals of this bill.

[190] Sec. 6708, as amended by other proposals of this bill.

In addition, the proposal increases the amount of these penalties. The penalty relating to not having a reasonable belief that the tax treatment was more likely than not the proper tax treatment is increased from $250 to $1,000. The penalty relating to willful or reckless conduct is increased from $1,000 to $5,000.

Effective Date

The proposal is effective for documents prepared after the date of enactment.

11. Penalty for failure to report interests in foreign financial accounts

Present Law

The Secretary of the Treasury must require citizens, residents, or persons doing business in the United States to keep records and file reports when that person makes a transaction or maintains an account with a foreign financial entity.[191] In general, individuals must fulfill this requirement by answering questions regarding foreign accounts or foreign trusts that are contained in Part III of Schedule B of the IRS Form 1040. Taxpayers who answer "yes" in response to the question regarding foreign accounts must then file Treasury Department Form TD F 90-22.1. This form must be filed with the Department of the Treasury, and not as part of the tax return that is filed with the IRS.

The Secretary of the Treasury may impose a civil penalty on any person who willfully violates this reporting requirement. The civil penalty is the amount of the transaction or the value of the account, up to a maximum of $100,000; the minimum amount of the penalty is $25,000.[192] In addition, any person who willfully violates this reporting requirement is subject to a criminal penalty. The criminal penalty is a fine of not more than $250,000 or imprisonment for not more than five years (or both); if the violation is part of a pattern of illegal activity, the maximum amount of the fine is increased to $500,000 and the maximum length of imprisonment is increased to 10 years.[193]

On April 26, 2002, the Secretary of the Treasury submitted to the Congress a report on these reporting requirements.[194] This report, which was statutorily required,[195] studies methods for improving compliance with these reporting requirements. It makes several administrative

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[191] 31 U.S.C. 5314.

[192] 31 U.S.C. 5321(a)(5).

[193] 31 U.S.C. 5322.

[194] *A Report to Congress in Accordance with Sec. 361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001,* April 26, 2002.

[195] Sec. 361(b) of the USA PATRIOT Act of 2001 (Pub. L. 107-56).

recommendations, but no legislative recommendations. A further report was required to be submitted by the Secretary of the Treasury to the Congress by October 26, 2002.

Description of Proposal

The proposal adds an additional civil penalty that may be imposed on any person who violates this reporting requirement (without regard to willfulness). This new civil penalty is up to $5,000. The penalty may be waived if any income from the account was properly reported on the income tax return and there was reasonable cause for the failure to report.

Effective Date

The proposal is effective with respect to failures to report occurring on or after the date of enactment.

12. Frivolous tax returns and submissions

Present Law

The Code provides that an individual who files a frivolous income tax return is subject to a penalty of $500 imposed by the IRS (sec. 6702). The Code also permits the Tax Court[196] to impose a penalty of up to $25,000 if a taxpayer has instituted or maintained proceedings primarily for delay or if the taxpayer's position in the proceeding is frivolous or groundless (sec. 6673(a)).

Description of Proposal

The proposal modifies the IRS-imposed penalty by increasing the amount of the penalty to up to $5,000 and by applying it to all taxpayers and to all types of Federal taxes.

The proposal also modifies present law with respect to certain submissions that raise frivolous arguments or that are intended to delay or impede tax administration. The submissions to which this proposal applies are requests for a collection due process hearing, installment agreements, offers-in-compromise, and taxpayer assistance orders. First, the proposal permits the IRS to dismiss such requests. Second, the proposal permits the IRS to impose a penalty of up to $5,000 for such requests, unless the taxpayer withdraws the request after being given an opportunity to do so.

The proposal requires the IRS to publish a list of positions, arguments, requests, and proposals determined to be frivolous for purposes of these proposals.

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[196] Because in general the Tax Court is the only pre-payment forum available to taxpayers, it deals with most of the frivolous, groundless, or dilatory arguments raised in tax cases.

Effective Date

The proposal is effective for submissions made and issues raised after the date on which the Secretary first prescribes the required list.

13. Regulation of individuals practicing before the Department of the Treasury

Present Law

The Secretary of the Treasury is authorized to regulate the practice of representatives of persons before the Department of the Treasury.[197] The Secretary is also authorized to suspend or disbar from practice before the Department a representative who is incompetent, who is disreputable, who violates the rules regulating practice before the Department, or who (with intent to defraud) willfully and knowingly misleads or threatens the person being represented (or a person who may be represented). The rules promulgated by the Secretary pursuant to this proposal are contained in Circular 230.

Description of Proposal

The proposal makes two modifications to expand the sanctions that the Secretary may impose pursuant to these statutory proposals. First, the proposal expressly permits censure as a sanction. Second, the proposal permits the imposition of a monetary penalty as a sanction. If the representative is acting on behalf of an employer or other entity, the Secretary may impose a monetary penalty on the employer or other entity if it knew, or reasonably should have known, of the conduct. This monetary penalty on the employer or other entity may be imposed in addition to any monetary penalty imposed directly on the representative. These monetary penalties are not to exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty. These monetary penalties may be in addition to, or in lieu of, any suspension, disbarment, or censure.

The proposal also confirms the present-law authority of the Secretary to impose standards applicable to written advice with respect to an entity, plan, or arrangement that is of a type that the Secretary determines as having a potential for tax avoidance or evasion.

Effective Date

The modifications to expand the sanctions that the Secretary may impose are effective for actions taken after the date of enactment.

14. Penalties on promoters of tax shelters

Present Law

A penalty is imposed on any person who organizes, assists in the organization of, or participates in the sale of any interest in, a partnership or other entity, any investment plan or

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[197] 31 U.S.C. 330.

arrangement, or any other plan or arrangement, if in connection with such activity the person makes or furnishes a qualifying false or fraudulent statement or a gross valuation overstatement.[198] A qualified false or fraudulent statement is any statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter. A "gross valuation overstatement" means any statement as to the value of any property or services if the stated value exceeds 200 percent of the correct valuation, and the value is directly related to the amount of any allowable income tax deduction or credit.

The amount of the penalty is $1,000 (or, if the person establishes that it is less, 100 percent of the gross income derived or to be derived by the person from such activity). A penalty attributable to a gross valuation misstatement can be waived on a showing that there was a reasonable basis for the valuation and it was made in good faith.

Description of Proposal

The proposal modifies the penalty amount to equal 50 percent of the gross income derived by the person from the activity for which the penalty is imposed. The new penalty rate applies to any activity that involves a statement regarding the tax benefits of participating in a plan or arrangement if the person knows or has reason to know that such statement is false or fraudulent as to any material matter. The enhanced penalty does not apply to a gross valuation overstatement.

Effective Date

The proposal is effective for activities after the date of enactment.

15. Extend statute of limitations for certain undisclosed transactions

Present Law

In general, the Code requires that taxes be assessed within three years[199] after the date a return is filed.[200] If there has been a substantial omission of items of gross income that total more than 25 percent of the amount of gross income shown on the return, the period during which an assessment must be made is extended to six years.[201] If an assessment is not made within the required time periods, the tax generally cannot be assessed or collected at any future

[198] Sec. 6700.

[199] Sec. 6501(a).

[200] For this purpose, a return that is filed before the date on which it is due is considered to be filed on the required due date (sec. 6501(b)(1)).

[201] Sec. 6501(e).

time. Tax may be assessed at any time if the taxpayer files a false or fraudulent return with the intent to evade tax or if the taxpayer does not file a tax return at all.[202]

Description of Proposal

The proposal extends the statute of limitations to six years with respect to the entire tax return[203] if a taxpayer required to disclose a listed transaction[204] fails to do so in the manner required. For example, if a taxpayer entered into a transaction in 2001 that becomes a listed transaction in 2002 and the taxpayer fails to disclose such transaction in the manner required by Treasury regulations, the 2001 tax return will be subject to a six-year statute of limitations.[205]

Effective Date

The proposal is effective for transactions entered into in taxable years beginning after the date of enactment.

16. Deny deduction for interest paid to IRS on underpayments involving certain tax-motivated transactions

Present Law

In general, corporations may deduct interest paid or accrued within a taxable year on indebtedness.[206] Interest on indebtedness to the Federal government attributable to an underpayment of tax generally may be deducted pursuant to this provision.

Description of Proposal

The proposal disallows any deduction for interest paid or accrued within a taxable year on any portion of an underpayment of tax that is attributable to an understatement arising from

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[202] Sec. 6501(c).

[203] The tax year extended is the tax year the transaction is entered into.

[204] The term "listed transaction" has the same meaning as described in a previous proposal regarding the penalty for failure to disclose reportable transactions.

[205] However, if the Treasury Department lists a transaction in a year subsequent to the year a taxpayer entered into such transaction, and the taxpayer's tax return for the year the transaction was entered into is closed by the statute of limitations prior to the transaction becoming a listed transaction, this proposal does not re-open the statute of limitations for such year.

[206] Sec. 163(a).

(1) an undisclosed reportable avoidance transaction, (2) an undisclosed listed transaction, or (3) a transaction that lacks economic substance.[207]

Effective Date

The proposal is effective for underpayments attributable to transactions entered into in taxable years beginning after the date of enactment.

17. Authorize additional $300 million per year to the IRS to combat abusive tax avoidance transactions

The proposal includes an authorization of an additional $300 million to the Internal Revenue Service to be used to combat abusive tax avoidance transactions.

[207] The definitions of these transactions are the same as those previously described in connection with the proposal to modify the accuracy-related penalty for listed and certain reportable transactions and the proposal to impose a penalty on understatements attributable to transactions that lack economic substance.

B. Other Provisions

1. Affirmation of consolidated return regulation authority

Present Law

An affiliated group of corporations may elect to file a consolidated return in lieu of separate returns. A condition of electing to file a consolidated return is that all corporations that are members of the consolidated group must consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for filing such return.[208]

Section 1502 states:

> The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent the avoidance of such tax liability.[209]

Under this authority, the Treasury Department has issued extensive consolidated return regulations.[210]

In the recent case of *Rite Aid Corp. v. United States*,[211] the Federal Circuit Court of Appeals addressed the application of a particular provision of certain consolidated return loss

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[208] Sec. 1501.

[209] Sec. 1502.

[210] Regulations issued under the authority of section 1502 are considered to be "legislative" regulations rather than "interpretative" regulations, and as such are usually given greater deference by courts in case of a taxpayer challenge to such a regulation. *See*, S. Rep. No. 960, 70th Cong., 1st Sess. at 15, describing the consolidated return regulations as "legislative in character". The Supreme Court has stated that "... legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984) (involving an environmental protection regulation). For examples involving consolidated return regulations, *see, e.g., Wolter Construction Company v. Commissioner*, 634 F.2d 1029 (6th Cir. 1980); *Garvey, Inc. v. United States*, 1 Ct. Cl. 108 (1983), *aff'd* 726 F.2d 1569 (Fed. Cir. 1984), *cert. denied* 469 U.S. 823 (1984). *Compare, e.g., Audrey J. Walton v. Commissioner*, 115 T.C. 589 (2000), describing different standards of review. The case did not involve a consolidated return regulation.

[211] 255 F.3d 1357 (Fed. Cir. 2001), *reh'g denied*, 2001 U.S. App. LEXIS 23207 (Fed. Cir. Oct. 3, 2001).

disallowance regulations, and concluded that the provision was invalid.[212] The particular provision, known as the "duplicated loss" provision,[213] would have denied a loss on the sale of stock of a subsidiary by a parent corporation that had filed a consolidated return with the subsidiary, to the extent the subsidiary corporation had assets that had a built-in loss, or had a net operating loss, that could be recognized or used later.[214]

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[212] Prior to this decision, there had been a few instances involving prior laws in which certain consolidated return regulations were held to be invalid. *See, e.g., American Standard, Inc. v. United States,* 602 F.2d 256 (Ct. Cl. 1979), discussed in the text *infra. see also Union Carbide Corp. v. United States*, 612 F.2d 558 (Ct. Cl. 1979), and *Allied Corporation v. United States*, 685 F. 2d 396 (Ct. Cl. 1982), all three cases involving the allocation of income and loss within a consolidated group for purposes of computation of a deduction allowed under prior law by the Code for Western Hemisphere Trading Corporations. *See also Joseph Weidenhoff v. Commissioner*, 32 T.C. 1222, 1242-1244 (1959), involving the application of certain regulations to the excess profits tax credit allowed under prior law, and concluding that the Commissioner had applied a particular regulation in an arbitrary manner inconsistent with the wording of the regulation and inconsistent with even a consolidated group computation. *Cf. Kanawha Gas & Utilities Co. v. Commissioner*, 214 F.2d 685 (1954), concluding that the substance of a transaction was an acquisition of assets rather than stock. Thus, a regulation governing basis of the assets of consolidated subsidiaries did not apply to the case. *See also General Machinery Corporation v. Commissioner*, 33 B.T.A. 1215 (1936); *Lefcourt Realty Corporation*, 31 B.T.A. 978 (1935); *Helvering v. Morgans, Inc.*, 293 U.S. 121 (1934), interpreting the term "taxable year."

[213] Treas. Reg. Sec. 1.1502-20(c)(1)(iii).

[214] Treasury Regulation section 1.1502-20, generally imposing certain "loss disallowance" rules on the disposition of subsidiary stock, contained other limitations besides the "duplicated loss" rule that could limit the loss available to the group on a disposition of a subsidiary's stock. Treasury Regulation section 1.1502-20 as a whole was promulgated in connection with regulations issued under section 337(d), principally in connection with the so-called *General Utilities* repeal of 1986 (referring to the case of *General Utilities & Operating Company v. Helvering*, 296 U.S. 200 (1935)). Such repeal generally required a liquidating corporation, or a corporation acquired in a stock acquisition treated as a sale of assets, to pay corporate level tax on the excess of the value of its assets over the basis. Treasury regulation section 1.1502-20 principally reflected an attempt to prevent corporations filing consolidated returns from offsetting income with a loss on the sale of subsidiary stock. Such a loss could result from the unique upward adjustment of a subsidiary's stock basis required under the consolidated return regulations for subsidiary income earned in consolidation, an adjustment intended to prevent taxation of both the subsidiary and the parent on the same income or gain. As one example, absent a denial of certain losses on a sale of subsidiary stock, a consolidated group could obtain a loss deduction with respect to subsidiary stock, the basis of which originally reflected the subsidiary's value at the time of the purchase of the stock, and that had then been adjusted upward on recognition of any built-in income or gain of the subsidiary reflected in that value. The regulations also contained the duplicated loss factor addressed by the court in *Rite Aid*. The preamble to the regulations stated: "it is not administratively feasible to differentiate

The Federal Circuit Court opinion contained language discussing the fact that the regulation produced a result different than the result that would have obtained if the corporations had filed separate returns rather than consolidated returns.[215]

The Federal Circuit Court opinion cited a 1928 Senate Finance Committee Report to legislation that authorized consolidated return regulations, which stated that "many difficult and complicated problems, ... have arisen in the administration of the provisions permitting the filing of consolidated returns" and that the committee "found it necessary to delegate power to the commissioner to prescribe regulations legislative in character covering them."[216] The Court's opinion also cited a previous decision of the Court of Claims for the proposition, interpreting this legislative history, that section 1502 grants the Secretary "the power to conform the applicable income tax law of the Code to the special, myriad problems resulting from the filing of consolidated income tax returns;" but that section 1502 "does not authorize the Secretary to choose a method that imposes a tax on income that would not otherwise be taxed." [217]

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between loss attributable to built-in gain and duplicated loss." T.D. 8364, 1991-2 C.B. 43, 46 (Sept. 13, 1991). The government also argued in the *Rite Aid* case that duplicated loss was a separate concern of the regulations. 255 F.3d at 1360.

[215] For example, the court stated: "The duplicated loss factor . . . addresses a situation that arises from the sale of stock regardless of whether corporations file separate or consolidated returns. With I.R.C. secs. 382 and 383, Congress has addressed this situation by limiting the subsidiary's potential future deduction, not the parent's loss on the sale of stock under I.R.C. sec. 165." 255 F.3d 1357, 1360 (Fed. Cir. 2001).

[216] S. Rep. No. 960, 70th Cong., 1st Sess. 15 (1928). Though not quoted by the court in *Rite Aid*, the same Senate report also indicated that one purpose of the consolidated return authority was to permit treatment of the separate corporations as if they were a single unit, stating "The mere fact that by legal fiction several corporations owned by the same shareholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit." S. Rep. No. 960, 70th Cong., 1st Sess. 29 (1928).

[217] *American Standard, Inc. v. United States*, 602 F.2d 256, 261 (Ct. Cl. 1979). That case did not involve the question of separate returns as compared to a single return approach. It involved the computation of a Western Hemisphere Trade Corporation ("WHTC") deduction under prior law (which deduction would have been computed as a percentage of each WHTC's taxable income if the corporations had filed separate returns), in a case where a consolidated group included several WHTCs as well as other corporations. The question was how to apportion income and losses of the admittedly consolidated WHTCs and how to combine that computation with the rest of the group's consolidated income or losses. The court noted that the new, changed regulations approach varied from the approach taken to a similar problem involving public utilities within a group and previously allowed for WHTCs. The court objected that the allocation method adopted by the regulation allowed non-WHTC losses to reduce WHTC income. However, the court did not disallow a method that would net WHTC income of one WHTC with losses of another WHTC, a result that would not have occurred under separate

The Federal Circuit Court construed these authorities and applied them to invalidate Treas. Reg. Sec. 1.1502-20(c)(1)(iii), stating that:

> The loss realized on the sale of a former subsidiary's assets after the consolidated group sells the subsidiary's stock is not a problem resulting from the filing of consolidated income tax returns. The scenario also arises where a corporate shareholder sells the stock of a non-consolidated subsidiary. The corporate shareholder could realize a loss under I.R.C. sec. 1001, and deduct the loss under I.R.C. sec. 165. The subsidiary could then deduct any losses from a later sale of assets. The duplicated loss factor, therefore, addresses a situation that arises from the sale of stock regardless of whether corporations file separate or consolidated returns. With I.R.C. secs. 382 and 383, Congress has addressed this situation by limiting the subsidiary's potential future deduction, not the parent's loss on the sale of stock under I.R.C. sec. 165.[218]

The Treasury Department has announced that it will not continue to litigate the validity of the duplicated loss provision of the regulations, and has issued interim regulations that permit taxpayers for all years to elect a different treatment, though they may apply the provision for the past if they wish.[219]

Description of Proposal

The proposal confirms that, in exercising its authority under section 1502 to issue consolidated return regulations, the Treasury Department may provide rules treating corporations filing consolidated returns differently from corporations filing separate returns.

Thus, under the statutory authority of section 1502, the Treasury Department is authorized to issue consolidated return regulations utilizing either a single taxpayer or separate taxpayer approach or a combination of the two approaches, as Treasury deems necessary in order that the tax liability of any affiliated group of corporations making a consolidated return, and of each corporation in the group, both during and after the period of affiliation, may be determined

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returns. Nor did the court expressly disallow a different fractional method that would net both income and losses of the WHTCs with those of other corporations in the consolidated group. The court also found that the regulation had been adopted without proper notice.

[218] *Rite Aid*, 255 F.3d at 1360.

[219] *See* Temp. Reg. 1.1502-20T(i)(2). The Treasury Department has also indicated its intention to continue to study all the issues that the original loss disallowance regulations addressed (including issues of furthering single entity principles) and possibly issue different regulations (not including the particular approach of Treas. Reg. Sec. 1.1502-20(c)(1)(iii)) on the issues in the future. *See* Notice 2002-11, 2002-7 I.R.B. 526 (Feb. 19, 2002); T.D. 8984, 67 F.R. 11034 (March 12, 2002); REG-102740-02, 67 F.R. 11070 (March 12, 2002); *see also* Notice 2002-18, 2002-12 I.R.B. 644 (March 25, 2002).

and adjusted in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such liability.

Rite Aid is thus overruled to the extent it suggests that there is not a problem that can be addressed in consolidated return regulations if application of a particular Code provision on a separate taxpayer basis would produce a result different from single taxpayer principles that may be used for consolidation.

The proposal nevertheless allows the result of the *Rite Aid* case to stand with respect to the type of factual situation presented in the case. That is, the legislation provides for the override of the regulatory provision that took the approach of denying a loss on a deconsolidating disposition of stock of a consolidated subsidiary[220] to the extent the subsidiary had net operating losses or built in losses that could be used later outside the group.[221]

Retaining the result in the *Rite Aid* case with respect to the particular regulation section 1.1502-20(c)(1)(iii) as applied to the factual situation of the case does not in any way prevent or invalidate the various approaches Treasury has announced it will apply or that it intends to consider in lieu of the approach of that regulation, including, for example, the denial of a loss on a stock sale if inside losses of a subsidiary may also be used by the consolidated group, and the possible requirement that inside attributes be adjusted when a subsidiary leaves a group.[222]

Effective Date

The proposal is effective for all years, whether beginning before, on, or after the date of enactment of the proposal.

No inference is intended that the results following from this proposal are not the same as the results under present law.

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[220] Treas. Reg. Sec. 1.1502-20(c)(1)(iii).

[221] The proposal is not intended to overrule the current Treasury Department regulations, which allow taxpayers for the past to follow Treasury Regulations Section 1.1502-20(c)(1)(iii), if they choose to do so. Temp. Reg. Sec. 1.1502-20T(i)(2).

[222] *See, e.g.*, Notice 2002-11, 2002-7 I.R.B. 526 (Feb. 19, 2002); T.D. 8984, 67 F.R. 11034 (Mar.12, 2002); REG-102740-02, 67 F.R. 11070 (Mar.12, 2002); *see also* Notice 2002-18, 2002-12 I.R.B. 644 (Mar. 25, 2002). In exercising its authority under section 1502, the Secretary is also authorized to prescribe rules that protect the purpose of *General Utilities* repeal using presumptions and other simplifying conventions.

Joint Committee on Taxation
February 5, 2003
JCX-5-03

DESCRIPTION OF CHAIRMAN'S MODIFICATIONS TO THE "ARMED FORCES TAX FAIRNESS ACT OF 2003"[1] SCHEDULED FOR A MARKUP BY THE SENATE COMMITTEE ON FINANCE ON FEBRUARY 5, 2003[2]

1. Suspension of tax-exempt status of terrorist organizations

The Chairman's modification clarifies that the proposal to suspend the tax-exempt status of certain terrorist organizations applies to organizations that are designated or identified as a terrorist organization prior to, on, or after the date of enactment. In addition, if an organization is designated or identified as a terrorist organization prior to the date of enactment, the suspension of the organization's tax-exemption begins from the date of enactment and is not retroactive to the date the organization is designated or identified as a terrorist organization.

2. Extension of certain tax relief provisions to astronauts

Present Law

The Victims of Terrorism Tax Relief Act of 2001 provided certain income and estate tax relief to individuals who die from wounds or injury incurred as a result of the terrorist attacks against the United States on September 11, 2001, and April 19, 1995 (the bombing of the Alfred P. Murrah Federal Building in Oklahoma City) or as a result of illness incurred due to an attack involving anthrax that occurred on or after September 11, 2001 and before January 1, 2002.

Description of Proposal

The Chairman's modification generally would extend benefits available under the Victims of Terrorism Tax Relief Act of 2001 (including an exclusion from income tax, an

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[1] A description of the provisions of the "Armed Forces Tax Fairness Act of 2003" is contained in Joint Committee on Taxation, *Description of the Chairman's Mark of the "Armed Forces Tax Fairness Act of 2003"* (JCX-2-03), February 3, 2003.

[2] This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Modifications to the "Armed Forces Tax Fairness Act of 2003" Scheduled for a Markup by the Senate Committee on Finance on February 5, 2003* (JCX-5-03), February 5, 2003.

exclusion for death benefits, and estate tax relief) to astronauts who lose their lives in the line of duty (including the individuals who lost their lives in the space shuttle Columbia disaster).

Effective Date

The provision is generally effective for qualified individuals whose lives are lost in the line of duty after December 31, 2002.

JOINT COMMITTEE ON TAXATION
February 5, 2003
JCX-6-03

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MODIFICATION TO THE "ARMED FORCES TAX FAIRNESS ACT OF 2003," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON FEBRUARY 5, 2003

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
I. Improving Tax Equity for Military Personnel														
A. Exclusion of Gain on Sale of a Principal Residence by a Member of the Uniformed Services or the Foreign Service (distance of 50 miles; extended stay of 90 days; maximum suspension of 10 years)	soea 5/6/97	-66	-14	-14	-15	-15	-16	-16	-17	-18	-18	-19	-139	-227
B. Exclusion from Gross Income of Certain Death Gratuity Payments	doa 9/10/01	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-6	-10
C. Exclusion for Amounts Received under Department of Defense Homeowners Assistance Program	pma DOE	[1]	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	-11	-22
D. Expansion of Combat Zone Filing Rules to Contingency Operations	[2]	-9	[1]	[1]	[1]	[1]	-1	-1	-1	-1	-1	-1	-11	-14
E. Modification of Membership Requirement for Exemption from Tax for Certain Veterans' Organizations	tyba DOE	-1	-1	-1	-1	-2	-2	-2	-2	-2	-2	-2	-8	-17
F. Clarification of Treatment of Certain Dependent Care Assistance Programs Provided to Members of the Uniformed Services of the United States	tyba 12/31/02	No Revenue Effect												
G. Treatment of Service Academy Appointments as Scholarships for Purposes of Qualified Tuition Programs and Coverdell Education Savings Accounts	tyba 12/31/02	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-1	-2
H. Suspension of Tax-Exempt Status of Designated Terrorist Organizations	[3]	Negligible Revenue Effect												
I. Above-the-Line Deduction for Overnight Travel Expenses of National Guard and Reserve Members Traveling More Than 100 Miles from Home	apoii tyba 12/31/02	-15	-75	-77	-78	-80	-82	-84	-87	-89	-91	-93	-407	-851
Total of Improving Tax Equity for Military Personnel		**-92**	**-93**	**-95**	**-97**	**-100**	**-104**	**-106**	**-110**	**-113**	**-115**	**-118**	**-583**	**-1,143**
II. Revenue Provisions														
A. Extension of IRS User Fees (through 9/30/13) [4]	rma DOE	---	33	34	35	36	38	39	41	42	44	45	176	386
B. Authorize IRS to Enter into Installment Agreements that Provide for Partial Payment	iaeio/a DOE	11	30	14	5	[5]	[5]	[5]	[5]	[5]	[5]	[5]	61	63
C. Impose Mark-to-Market on Individuals Who Expatriate	[6]	3	98	84	80	74	71	67	61	57	54	51	410	700
Total of Revenue Provisions		**14**	**161**	**132**	**120**	**110**	**109**	**106**	**102**	**99**	**98**	**96**	**647**	**1,149**

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
III. Extend the Benefits Available Under the "Victims of Terrorism Tax Relief Act of 2001" (including an exclusion from income tax, an exclusion for death benefits, and estate tax relief) to Astronauts who Lose Their Lives in the Line of Duty (including the individuals who lost their lives in the space shuttle Columbia disaster)	[7]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
NET TOTAL		**-78**	**68**	**37**	**23**	**10**	**5**	**[1]**	**-8**	**-14**	**-17**	**-22**	**64**	**6**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

apoii = amounts paid or incurred in
doa = deaths occurring after
DOE = date of enactment
iaeio/a = installment agreements entered into on or after
pma = payments made after
rma = requests made after
tyba = taxable years beginning after
soea = sales or exchanges after

[1] Loss of less than $500,000.
[2] The provision applies to any period for performing an act that has not expired before the date of enactment.
[3] Effective for organizations that are designated or identified as a terrorist organization prior to, on, or after the date of enactment.
[4] Estimate provided by Congressional Budget Office.
[5] Gain of less than $500,000.
[6] Generally effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after February 5, 2003.
[7] Generally effective for qualified individuals whose lives are lost in the line of duty after December 31, 2002.

Joint Committee on Taxation
February 5, 2003
JCX-07-03

DESCRIPTION OF CHAIRMAN'S MODIFICATIONS TO THE PROVISIONS OF THE "CARE ACT OF 2003" SCHEDULED FOR A MARKUP BY THE SENATE COMMITTEE ON FINANCE ON FEBRUARY 5, 2003[1]

A. Modifications to the CARE Act of 2003

The following modifications are made to the provisions of the CARE Act of 2003.[2]

1. Notification requirement for exempt entities not currently required to file an annual information return

The proposal requires certain tax-exempt organizations that are exempt from the information return (Form 990) filing requirement to file an annual notice with the Secretary of the Treasury. The penalty for failure to file the notice for three consecutive years is loss of exempt status.

The Chairman's modification extends the penalty of revocation of tax-exempt status to organizations that are required to file an information return under section 6033(a) (Form 990). Under the modification, if an organization fails to file such an information return for three consecutive years, the organization's tax-exempt status is revoked. In addition, an organization's tax-exemption is revoked if the organization fails to meet its filing obligation to the Secretary for three consecutive years in cases where the organization is subject to the information return requirement in one or more years during a three-year period and also is subject to the notice requirement for one or more years during the same three-year period.

The revocation is effective from the date that the Secretary determines was the last day the organization could have timely filed the third required information return or notice. To again be recognized as tax-exempt, the organization must apply to the Secretary for recognition of tax-

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Modifications to the Provisions of the "CARE Act of 2003" Scheduled for a Markup By the Senate Committee on Finance on February 5, 2003* (JCX-07-03), February 5, 2003.

[2] A description of the provisions of the "CARE Act of 2003" is contained in Joint Committee on Taxation, *Description of the "CARE Act of 2003"* (JCX-04-03), February 3, 2003.

exemption, irrespective of whether the organization was required to make an application for recognition of tax-exemption in order to gain tax-exemption originally.

If, upon application for tax-exempt status after a revocation under the proposal, the organization shows to the satisfaction of the Secretary reasonable cause for failing to timely file the required annual returns, the organization's tax-exempt status will be reinstated retroactive to the date of revocation. An organization may not challenge under the Internal Revenue Code's declaratory judgment procedures (section 7428) a revocation of tax-exemption made pursuant to the modification. The modification does not affect an organization's obligation under present law to file required information returns or existing penalties for failure to file such returns.

In addition to the Secretary's outreach requirements described in the Chairman's mark with respect to the notice, the Secretary is required to publicize in a timely manner the requirements of the modification in appropriate forms and instructions and other means of outreach, with respect to the penalty for failure to file the information return. The Secretary is authorized to publish a list of organizations whose exempt status is revoked under the modification.

2. Suspension of tax-exempt status of terrorist organizations

The Chairman's modification clarifies that the proposal to suspend the tax-exempt status of certain terrorist organizations applies to organizations that are designated or identified as a terrorist organization prior to, on, or after the date of enactment. In addition, if an organization is designated or identified as a terrorist organization prior to the date of enactment, the suspension of the organization's tax-exemption begins from the date of enactment and is not retroactive to the date the organization is designated or identified as a terrorist organization.

3. Payments by charitable organizations to victims of war on terrorism

The Chairman's modification extends the proposal to apply to the families of astronauts killed in the line of duty. The Chairman's modification is effective for astronauts killed and payments made since January 1, 2003.

4. Revenue raising proposals

The Chairman's modification changes the effective date with respect to the clarification of the economic substance doctrine (and the related penalty for transactions that lack economic substance) to transactions after February 15, 2004.

B. New Provisions

The Chairman's modification would add the following provisions to the CARE Act of 2003:

1. Charitable contribution deduction for certain expenses in support of Native Alaskan subsistence whaling

Present Law

In computing taxable income, individuals who do not elect the standard deduction may claim itemized deductions, including a deduction (subject to certain limitations) for charitable contributions or gifts made during the taxable year to a qualified charitable organization or governmental entity.[3] Individuals who elect the standard deduction may not claim a deduction for charitable contributions made during the taxable year.

No charitable contribution deduction is allowed for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization, contributions to which are deductible, may constitute a deductible contribution.[4] Specifically, section 170(j) provides that no charitable contribution deduction is allowed for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

Description of Proposal

The proposal allows individuals to claim a deduction under section 170 not exceeding $10,000 per taxable year for certain expenses incurred in carrying out sanctioned whaling activities. The deduction would be available only to an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities. The deduction would be available for reasonable and necessary expenses paid by the taxpayer during the taxable year for: (1) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities, (2) the supplying of food for the crew and other provisions for carrying out such activities, and (3) storage and distribution of the catch from such activities.

For purposes of the provision, the term "sanctioned whaling activities" means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission.

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[3] Sec. 170. Section references are to the Internal Revenue Code of 1986 unless otherwise indicated.

[4] Treas. Reg. sec. 1.170A-1(g).

Effective Date

The proposal is effective for contributions made after December 31, 2003.

2. Matching grants to low-income taxpayer clinics for return preparation

Present Law

The Secretary is authorized to provide up to $6 million per year in matching grants to certain low-income taxpayer clinics that represent low-income taxpayers in controversies with the IRS or that operate programs to inform individuals for whom English is a second language about their tax-related rights and responsibilities.[5]

Description of Proposal

The provision authorizes the Secretary to create a separate grant program to provide up to $10 million per year in matching grants to not for profit organizations that assist low-income taxpayers in the preparation of their Federal tax returns.

Effective Date

The provision is effective on the date of enactment.

3. Extend enhanced deduction for inventory to include public schools

Present Law

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

However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis.[6] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

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[5] Sec. 7526.

[6] Sec. 170(e)(3). In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income. Sec. 170(b)(2).

Donations to educational organizations described in section 170(b)(1)(A)(ii) are not eligible to receive the enhanced deduction. An organization is described in section 170(b)(1)(A)(ii) if it normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. Donations to such organizations are eligible to receive an enhanced deduction if the donation qualifies as a qualified computer contribution.[7]

Description of Proposal

The proposal would extend the enhanced deduction for inventory property to donations to educational organizations described in section 170(b)(1)(A)(ii). Charitable contributions of computer technology and equipment continue to be covered by the present law enhanced deduction of section 170(e)(6) and are not eligible property for an enhanced deduction under the proposal.

The proposal retains present law requirements that the donated property be used solely for the care of the ill, the needy, or infants, (2) that the organization not transfer the property in exchange for money, other property, or services, and (3) that the organization provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.

Effective Date

The proposal is effective for contributions made after December 31, 2003.

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[7] Sec. 170(e)(6).

JOINT COMMITTEE ON TAXATION
February 5, 2003
JCX-8-03

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MODIFICATION TO THE "CARE ACT OF 2003," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON FEBRUARY 5, 2003

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
I. Charitable Giving Incentive Provisions														
1. Provide charitable contribution deduction for non-itemizers with cash contributions in excess of $250 for individuals and $500 for joint returns; cap on deduction of $250 for individuals and $500 for joint returns	tyba 12/31/02 & tybb 1/1/05	-204	-1,368	-1,218	---	---	---	---	---	---	---	---	-2,790	-2,790
2. Tax-free distributions from IRAs for charitable purposes - taxpayer must have attained age 70-1/2 for contributions made directly to a charitable organization and age 59-1/2 for contributions to a split-interest entity	DOE & tyba 12/31/03	-48	-156	-248	-270	-258	-244	-231	-247	-352	-450	-471	-1,223	-2,974
3. Extend present-law section 170(e)(3) deduction for food inventory to all businesses and provide special basis rule for certain taxpayers; modify the enhanced deduction for charitable contributions of donations of food inventory to equal the lesser of the item's fair market value or twice basis	cma DOE	-59	-154	-173	-185	-193	-201	-209	-217	-225	-234	-246	-965	-2,094
4. Enhanced charitable deduction for contributions of book inventories, with special fair market value rule	cma DOE	-8	-17	-19	-21	-23	-25	-28	-31	-33	-37	-41	-113	-283
5. Expand charitable contribution allowed for scientific property used for research and for computer technology and equipment; and temporary extension of enhanced deduction for qualified computer contributions (through 12/31/05)	generally tyba 12/31/02	-1	-67	-133	-147	-65	-1	-1	-1	-1	-1	-1	-414	-420
6. Encourage contributions of capital gain real property made for conservation purposes	cma DOE	-3	-5	-9	-13	-16	-23	-32	-41	-51	-62	-75	-70	-332
7. 25% capital gain exclusion for sales or exchanges of land or interest in land or water to eligible entities for conservation purposes	soeoa DOE	-7	-56	-60	-67	-70	-74	-78	-82	-86	-91	-95	-334	-766
8. Exclusion for government payments under Partners for Fish and Wildlife Program	pra DOE	-1	-2	-2	-3	-3	-3	-3	-3	-3	-3	-3	-12	-26
9. Adjustment to basis of S corporation stock for certain charitable contributions	cma DOE	-8	-22	-30	-33	-37	-41	-45	-50	-55	-62	-68	-172	-453
10. Enhanced deduction for charitable contributions of literary, musical, artistic, and scholarly compositions	cma DOE	-2	-4	-4	-5	-5	-6	-6	-6	-7	-7	-7	-26	-59
11. Certain mileage reimbursements to charitable volunteers excluded from gross income	tyba DOE	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-1	-3
Total of Charitable Giving Incentive Provisions		-341	-1,851	-1,896	-744	-670	-618	-633	-678	-813	-947	-1,007	-6,120	-10,200

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
12. Provide an equal enhanced deduction for qualified corporate contributions of inventory to public schools as currently allowed for contributions to private schools; computer technology and equipment are not eligible property	cma 12/31/03	---	-17	-28	-31	-34	-38	-41	-46	-50	-55	-59	-148	-399
13. Matching grants to low-income taxpayer clinics for return preparation	DOE	No Revenue Effect												
Total of Other Charitable and Exempt Organization Provisions		-33	-48	-71	-79	-85	-93	-99	-109	-117	-128	-138	-410	-1,001
IV. Restoration of Social Services Block Grant Funding (outlays) [4]	[5]	-238	-946	-278	23	16	27	20	---	---	---	---	-1,395	-1,375
V. Individual Development Accounts - provide a tax credit to eligible entities with respect to the first 300,000 individual development accounts established for low-income workers	tyea 12/31/04 & tybb 1/1/12	---	---	-24	-44	-39	-61	-76	-90	-104	-48	[1]	-169	-487
VI. Authorization of Appropriations	---	No Revenue Effect												
VII. Revenue Raising Proposals														
A. Provisions to Curtail Tax Shelters														
1. Clarification of the economic substance doctrine and related penalty provisions	ta 2/15/04	-258	552	1,119	1,042	927	965	1,079	1,213	1,395	1,607	1,848	4,347	11,490
2. Provisions relating to reportable transactions and tax shelters	various dates after DOE [6]	35	92	115	119	120	124	131	139	150	164	179	604	1,366
3. Modification to the substantial understatement penalty [7]	ta DOE	---	---	4	11	19	23	26	30	34	38	38	57	223
4. Actions to enjoin conduct with respect to tax shelters	DOE	Negligible Revenue Effect												
5. Understatement of taxpayer's liability by income tax return preparer	dpa DOE	Negligible Revenue Effect												
6. Impose a civil penalty (of up to $5,000) on failure to report interest in foreign financial accounts	DOE	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	1	3
7. Frivolous tax submissions	[9]	1	3	3	3	3	3	3	3	3	3	3	16	31
8. Regulation of individuals practicing before the Department of Treasury	ata DOE	No Revenue Effect												
9. Amend Code section 6501 to provide for 6-year statute of limitations for undisclosed listed transactions	tyba DOE	---	---	---	1	1	1	1	1	1	1	1	3	8
10. Amend Code section 163 to disallow a deduction for deficiency interest paid to the IRS on underpayments involving tax motivated transactions	tyba DOE	---	---	---	1	1	3	4	4	4	4	4	5	25
11. Additional $300 million tax law enforcement authorization for the IRS [4]	DOE	No Revenue Effect												

COMPARISON OF THE PROVISIONS OF H. R. 1307, THE "ARMED FORCES TAX FAIRNESS ACT OF 2003," AS PASSED BY THE HOUSE AND THE SENATE

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

April 1, 2003
JCX-23-03

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the provisions of H.R. 1307, the "Armed Forces Tax Fairness Act of 2003," as passed by the House of Representatives on March 20, 2003, and by the Senate on March 27, 2003.

[1] This document may be cited as follows: Joint Committee on Taxation, *Comparison of the Provisions of H. R. 1307, the "Armed Forces Tax Fairness Act of 2003," as passed by the House and the Senate* (JCX-23-03), April 1, 2003.

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
I. IMPROVING TAX EQUITY FOR MILITARY PERSONNEL			
A. Exclusion from Gross Income of Certain Death Gratuity Payments (sec. 3 of the House bill and sec. 102 of the Senate amendment)	Qualified military benefits (including certain death gratuities) are excludable from gross income subject to certain restrictions. Generally, other than certain cost-of-living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion.	Extends the exclusion for certain death gratuities to any adjustment to the amount of the death gratuity payable pursuant to a provision of law enacted before December 31, 1991. Effective date.–Deaths occurring after September 10, 2001.	Extends the exclusion for certain death gratuities to any adjustment to the amount of death gratuities payable (including but not limited to any adjustment to the amount of the death gratuity payable pursuant to a provision of law enacted before December 31, 1991). Effective date.–Same as House bill.
B. Exclusion of Gain on Sale of a Principal Residence by a Member of the Uniformed Services (sec. 2 of the House bill and sec. 101 of the Senate amendment)	An individual may elect to exclude up to $250,000 ($500,000 for joint returns) of gain from the sale or exchange of a principal residence. A five-year test period for ownership and use of the property is generally applied to determine eligibility for the exclusion. There are no special rules with respect to the sale or exchange of a principal residence for members of the uniformed services, or the Foreign Service of the U.S.	An individual may elect to suspend for a maximum of five years the five-year test period for ownership and use during certain absences due to service in the uniformed services. Such absences must be with respect to any period of extended duty by a member of the uniformed services of the United States while serving at a place of duty at least 150 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as any period of active duty pursuant to a call or order to such duty for a	Same as House bill with the following modifications: 1. Allows a maximum 10-year suspension; 2. Reduces 150 miles to 50 miles; 3. Reduces 180 days to 90 days; and 4. Extends the provision to members of the Foreign Service of the United States. Effective date.–Same as the House bill.

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
		period in excess of 180 days or for an indefinite period. H.R. 1308 as passed by the House extends identical relief to members of the Foreign Service as the provision in the Senate amendment Effective date.–Sales or exchanges after May 6, 1997.	
C. Exclusion for Amounts Received Under Department of Defense Homeowners Assistance Program (sec. 4 of the House bill and sec. 103 of the Senate amendment)	Amounts received under the Department of Defense Homeowners Assistance Program are includible in gross income as compensation for services. Such amounts are wages for FICA tax purposes (including Medicare).	Amounts received under the Program (as in effect on the date of enactment) are excludable from income and not considered wages for FICA tax purposes (including Medicare). Effective date.–Payments made after the date of enactment.	Same as House bill.
D. Expansion of Combat Zone Filing Rules to Contingency Operations (sec. 5 of the House bill and sec. 104 of the Senate amendment)	In general, the period of time for performing certain acts under the Internal Revenue Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, is suspended for any individual serving in the Armed Forces of the United States in an area designated as a "combat zone" during the period of combatant activities.	Applies the combat zone rules to any contingency operation or operation that becomes a contingency operation. Effective date.–Applies to any period for performing an act that has not expired before the date of enactment.	Same as House bill.

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
E. Above-the-Line Deduction for Overnight Travel Expenses of National Guard and Reserve Members (sec. 9 of the House bill and sec. 109 of the Senate amendment)	National Guard and Reserve members may claim itemized deductions for their nonreimbursable expenses for transportation, meals, and lodging when they must travel away from home (and stay overnight) to attend National Guard and Reserve meetings.	Provides an above-the-line deduction for the overnight transportation, meals, and lodging expenses up to $1,500 per year for National Guard and Reserve members who must travel away from home more than 100 miles (and stay overnight) to perform services as a National Guard or Reserve member. Effective date.–Amounts paid or incurred in taxable years beginning after December 31, 2002.	Same as the House bill except the otherwise allowable deduction is: (1) not subject to the $1,500 cap; and (2) limited by the Federal government per diem rates.
F. Modification of Membership Requirement for Exemption From Tax for Certain Veteran's Organizations (sec. 6 of the House bill and sec. 105 of the Senate amendment)	A veterans' organization as described in section 501(c)(19) of the Code generally is exempt from Federal income tax. In order to qualify for the exemption (1) at least 75 percent of the organization's members must be past or present members of the Armed Forces of the United States, and (2) "substantially all" of the remaining members must be cadets or spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets.	Permits ancestors or lineal descendants of past or present members of the Armed Forces of the United States or of cadets to qualify as members for purposes of the "substantially all" test. Effective date.–Taxable years beginning after the date of enactment.	Same as House bill.

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
G. Clarification of Treatment of Certain Dependent Care Assistance Programs Provided to Members of the Uniformed Services of the United States (sec. 7 of the House bill and sec. 106 of the Senate amendment)	Qualified military benefits are excludable from gross income subject to certain restrictions. Generally, a qualified military benefit is any allowance or in-kind benefit (other than personal use of a vehicle) which: (1) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services; and (2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date. Generally, other than certain cost-of-living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion from gross income. There may be some confusion regarding the treatment of dependent care assistance as qualified military benefits.	Clarifies that dependent care assistance provided under a dependent care assistance program (as in effect on the date of enactment) for a member of the uniformed services by reason of such member's status or service as a member of the uniformed services is excludable from gross income as a qualified military benefit. For these purposes, the amount of dependent care assistance excludable as a qualified military benefit is not limited to the amount of benefit excludable on September 9, 1986. <u>Effective date</u>.–Taxable years beginning after December 31, 2002. No inference is intended as to the tax treatment of such amounts for prior taxable years.	Same as House bill.

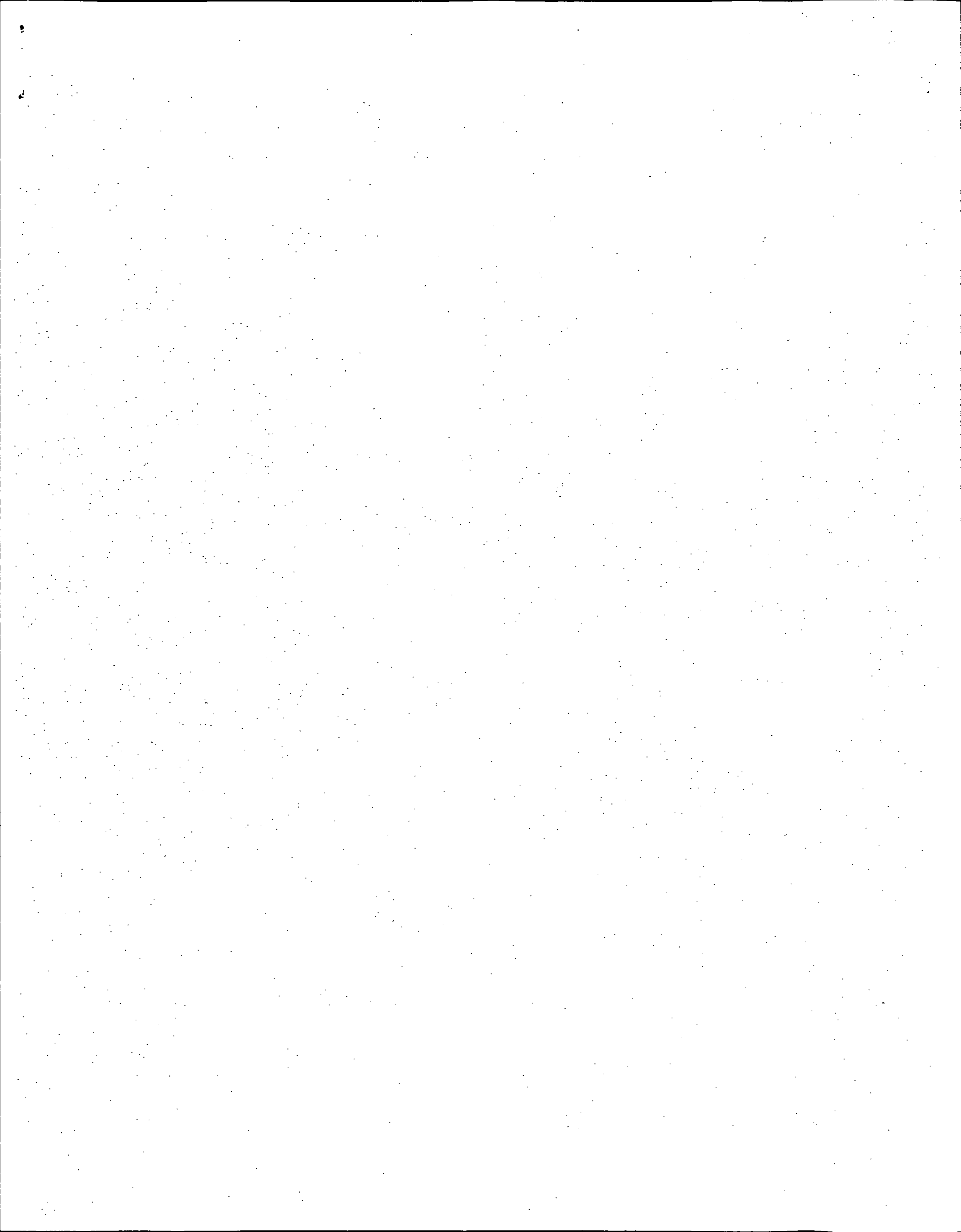
ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
H. Treatment of Service Academy Appointments for purposes of Qualified Tuition Programs and Coverdell Education Savings Accounts (sec. 8 of the House bill and sec. 107 of the Senate amendment)	Withdrawals from qualified tuition programs and Coverdell education savings accounts for qualified education expenses are excludable from gross income. Withdrawals that are not for qualified education expenses are includible in gross income (except to the extent attributable to nondeductible contributions) and, unless an exception applies, are subject to an additional 10-percent tax penalty.	The House bill permits penalty free withdrawals from qualified tuition programs and Coverdell education savings accounts made on account of attendance of the beneficiary at a U.S. service academy. The amount of funds that can be withdrawn penalty free with respect to any academic period is limited to the costs of advance education (as defined under 10 US.C. 2005(e)(3) as in effect on the date of enactment) at the Academy attended by the designated beneficiary for the same academic period. Effective date.–Taxable years beginning after December 31, 2002.	Same as House bill.

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
I. Suspension of Tax-Exempt Status of Terrorist Organizations (sec. 108 of the Senate amendment)	The IRS can revoke the tax-exempt status of an organization only after certain administrative steps are taken. There is no procedure for the IRS to suspend the tax-exempt status of a tax-exempt organization.	No provision. However, H.R. 1308 as passed by the House provides identical treatment to the provision in the Senate amendment.	Suspends the tax-exempt status of an organization for any period for which the organization is designated or identified by appropriate Federal authority as a terrorist organization or as supporting or engaging in terrorism. Effective date.–Date of enactment.
J. Tax Relief for Astronauts (sec. 110 of the Senate amendment)	Certain income and estate tax relief is provided for victims of the terrorist attacks on September 11, 2001, and April 19, 1995, or the anthrax attack of 2001.	No provision. However, H.R. 1308 as passed by the House provides relief similar to the Senate amendment.	Extends similar tax relief to astronauts who lose their lives in the line of duty. Effective date.–Individuals who lose their lives after December 31, 2002.
II. OTHER PROVISIONS			
A. Impose Mark-to-Market Tax on Individuals Who Expatriate (sec. 203 of the Senate amendment)	In general, an individual who relinquishes U.S. citizenship or terminates U.S. residency with a principal purpose of avoiding U.S. taxes is subject to an alternative tax regime for income tax purposes for the 10 taxable years ending after expatriation or residency termination. The alternative tax regime generally expands the category of income that is considered taxable U.S.-source	No provision.	Generally subjects certain U.S. citizens who relinquish U.S. citizenship and certain long-term U.S. residents who terminate U.S. residency to tax on the net unrealized gain in their property as if such property were sold for fair market value on the day before the expatriation or residency termination (a so-called "mark-to-market" approach), without regard to the individual's purpose for

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
	income, and imposes gain recognition on certain transactions that otherwise might convert U.S.-source income into foreign-source income. Special rules apply to such individuals for estate and gift tax purposes. A special immigration rule denies certain former citizens re-entry into the United States if the Attorney General determines that their expatriation was tax-motivated.		expatriation or residency termination. Exceptions apply if the deemed gain is below a certain amount, or if the individual falls within certain categories. Special rules are provided for interests in trusts, qualified retirement plans and foreign pension plans. The bill generally requires a U.S. taxpayer who receives a gift or inheritance from an expatriate to recognize the value of the property as gross income. In addition, the bill conforms the present-law immigration rule to the mark-to-market tax regime. Effective date.–Generally effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their U.S. residency on or after February 5, 2003. The gift and inheritance provision is effective for gifts and inheritances received from expatriates on or after February 5, 2003, whose expatriation or residency termination occurs on or after that date. The immigration provision is effective on or after date of enactment.

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
B. Extension of IRS User Fees (sec. 201 of the Senate amendment)	The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104-117 extended the statutory authorization for these user fees through September 30, 2003.	No provision.	Extends the statutory authorization for these user fees through September 30, 2013. Also moves the statutory authorization for these fees into the Internal Revenue Code. Effective date.–Requests made after the date of enactment.
C. Authorize IRS to Enter into Installment Agreements that Provide for Partial Payment (sec. 202 of the Senate amendment)	The IRS is authorized to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed. Since the issuance in 1998 of a memorandum by the IRS Chief Counsel, the IRS has taken the position that partial payment installment agreements are not permitted.	No provision.	Clarifies that the IRS is authorized to enter into installment agreements with taxpayers that do not provide for full payment of the taxpayer's liability over the life of the agreement. The provision also requires the IRS to review partial payment installment agreements at least every two years. Effective date.–Installment agreements entered into on or after the date of enactment.

ITEM	PRESENT LAW	HOUSE BILL	SENATE AMENDMENT
D. Protection of Social Security (sec. 10 of the House bill)	Present law provides for the transfer of Social Security taxes and certain self-employment taxes to the Social Security trust funds. In addition, the income tax collected with respect to a portion of Social Security benefits included in gross income is transferred to the Social Security trust funds.	The House bill provides that any amounts to be transferred to any trust fund under Title II of the Social Security Act are determined as if the House bill had not been enacted. This will ensure that the income and balances of those Social Security trust funds are not reduced as a result of the House bill.	No provision.



JOINT COMMITTEE ON TAXATION
April 1, 2003
JCX-24-03

COMPARISON OF THE ESTIMATED BUDGET EFFECTS OF H.R. 1307, THE "ARMED FORCES TAX FAIRNESS ACT OF 2003," AS PASSED BY THE HOUSE OF REPRESENTATIVES AND THE SENATE

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	H.R. 1307, as Passed by the House of Representatives								H.R. 1307, as Passed by the Senate							
		2003	2004	2005	2006	2007	2008	2003-08	2003-13	2003	2004	2005	2006	2007	2008	2003-08	2003-13
Improving Tax Equity for Military Personnel																	
1. Increase death gratuity exclusion to present levels of death gratuity; (S) but provide for automatic increase in exclusion as death gratuities increase	doa 9/10/01	-1	-1	-1	-1	-1	-1	-6	-10	-1	-1	-1	-1	-1	-1	-6	-10
2. Exclusion of gain on sale of a principal residence by a member of the uniformed services [1] (H) 5-year suspension, 150 miles, and 180 days; (S) 10-year suspension, 50 miles, and 90 days	soea 5/6/97	-64	-13	-14	-14	-15	-15	-136	-221	-66	-14	-14	-15	-15	-16	-139	-227
3. Exclusion for amounts received under Department of Defense Homeowners Assistance Program	pma DOE	[2]	-2	-2	-2	-2	-2	-11	-22	[2]	-2	-2	-2	-2	-2	-11	-22
4. Expansion of combat zone filing rules to contingency operations	[3]	-9	[2]	[2]	[2]	[2]	-1	-11	-14	-9	[2]	[2]	[2]	[2]	-1	-11	-14
5. Above-the-line deduction (H) up to $1,500, without per diem limit (S) not subject to $1,500 cap, for overnight travel expenses of National Guard and reserve members traveling more than 100 miles from home	apoli tyba 12/31/02	-10	-52	-52	-53	-53	-54	-275	-551	-15	-75	-77	-78	-80	-82	-407	-851
6. Modification of membership requirement for exemption from tax for certain veterans' organizations	tyba DOE	-1	-1	-1	-1	-2	-2	-8	-17	-1	-1	-1	-1	-2	-2	-8	-17
7. Clarification of treatment of certain dependent care assistance programs provided to members of the uniformed services of the United States	tyba 12/31/02	No Revenue Effect								No Revenue Effect							
8. Treatment of service academy appointments as scholarships for purposes of qualified tuition programs and Coverdell Education Savings Accounts	tyba 12/31/02	[2]	[2]	[2]	[2]	[2]	[2]	-1	-2	[2]	[2]	[2]	[2]	[2]	[2]	-1	-2
9. Suspension of tax-exempt status of designated terrorist organizations	[4]	No Provision [5]								Negligible Revenue Effect							
10. Extend the Benefits Available Under the "Victims of Terrorism Tax Relief Act of 2001" (including an exclusion from income tax, an exclusion for death benefits, and estate tax relief) to Astronauts who Lose Their Lives in the Line of Duty (including the individuals who lost their lives in the space shuttle Columbia disaster)	[6]	No Provision [7]								[2]	[2]	[2]	[2]	[2]	[2]	[2]	[2]
Total of Improving Tax Equity for Military Personnel		-85	-69	-70	-71	-73	-75	-448	-837	-92	-93	-95	-97	-100	-104	-583	-1,143
Other Provisions																	
1. Impose Mark-to-Market on Individuals Who Expatriate	[8]	No Provision								3	98	84	80	74	71	410	700
2. Extension of IRS User Fees (through 9/30/13) [9]	rma DOE	No Provision								---	33	34	35	36	38	176	386
3. Authorize IRS to Enter into Installment Agreements that Provide for Partial Payment	iaeio/a DOE	No Provision								11	30	14	5	[10]	[10]	61	63

Provision	Effective	H.R. 1307, as Passed by the House of Representatives								H.R. 1307, as Passed by the Senate							
		2003	2004	2005	2006	2007	2008	2003-08	2003-13	2003	2004	2005	2006	2007	2008	2003-08	2003-13
4. No Impact on Social Security Trust Funds	DOE	No Revenue Effect								No Provision							
Total of Other Provisions		No Revenue Effect								14	161	132	120	110	109	647	1,149
NET TOTAL		-85	-69	-70	-71	-73	-75	-448	-837	-78	68	37	23	10	5	64	6

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend: (H) = H.R. 1307, as Passed by the House of Representatives on March 20, 2003.
(S) = H.R. 1307, as Passed by the Senate on March 27, 2003.

Legend for "Effective" column:
apoii = amounts paid or incurred in
doa = deaths occurring after
DOE = date of enactment
iaeio/a = installment agreements entered into on or after
pma = payments made after
rma = requests made after
soea = sales or exchanges after
tyba = taxable years beginning after

[1] H.R. 1308, as passed by the House of Representatives, provides relief identical to members of the Foreign Service as the provision in the Senate amendment.
[2] Loss of less than $500,000.
[3] The provision applies to any period for performing an act that has not expired before the date of enactment.
[4] Effective for organizations that are designated or identified as a terrorist organization before, on, or after the date of enactment.
[5] No provision, however, H.R. 1308, as passed by the House of Representatives, provides relief identical to the provision in the Senate amendment.
[6] Generally effective for qualified individuals whose lives are lost in the line of duty after December 31, 2002.
[7] No provision, however, H.R. 1308, as passed by the House of Representatives, provides relief similar to the provision in the Senate amendment.
[8] Generally effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after February 5, 2003.
[9] Estimate provided by Congressional Budget Office.
[10] Gain of less than $500,000.

TECHNICAL EXPLANATION OF H.R. 1664, THE "ARMED FORCES TAX FAIRNESS ACT OF 2003"

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

April 9, 2003
JCX-37-03

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of H.R. 1664, the "Armed Forces Tax Fairness Act of 2003."

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[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of H.R. 1664, the "Armed Forces Tax Fairness Act of 2003"* (JCX-37-03), April 9, 2003.

EXPLANATION OF THE BILL

A. Exclusion of Gain on Sale of a Principal Residence by a Member of the Uniformed Services or the Foreign Service (sec. 2 of the bill and sec. 121 of the Code)

Present Law

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000, if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to members of the uniformed services or the Foreign Service of the United States.

Explanation of Provision

Under the bill, an individual may elect to suspend for a maximum of five years the five-year test period for ownership and use during certain absences due to service in the uniformed services, or the Foreign Service of the United States. The uniformed services include: (1) the Armed forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to five years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty as a member of the uniformed services, or in Foreign Service of the United States. For these purposes, qualified official extended duty is any period of extended duty by a member of the uniformed services, or the Foreign Service of the United States while serving at a place of duty at least 150 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 180 days or for an indefinite period. The election may be made with respect to only one property for a suspension period.

Effective Date

The provision is effective for sales or exchanges after May 6, 1997.

B. Exclusion from Gross Income of Certain Death Gratuity Payments (sec. 3 of the bill and sec. 134 of the Code)

Present Law

Present law provides that qualified military benefits are not included in gross income. Generally, a qualified military benefit is any allowance or in-kind benefit (other than personal use of a vehicle) which: (1) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services; and (2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date. Generally, other than certain cost of living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion from gross income. Qualified military benefits include certain death gratuities. The amount of the death gratuity military benefit was increased to $6,000 but the amount of the exclusion from gross income was not increased to take into account this change.

Explanation of Provision

The bill extends the exclusion from gross income to any adjustment to the amount of the death gratuity payable under Chapter 75 of Title 10 of the United States Code that is pursuant to a provision of law enacted before December 31, 1991, with respect to the death of certain members of the Armed services on active duty, inactive duty training, or engaged in authorized travel. Therefore, the amount of the exclusion is increased to $6,000.

Effective Date

The provision is effective with respect to deaths occurring after September 10, 2001.

C. Exclusion for Amounts Received Under Department of Defense Homeowners Assistance Program (sec. 4 of the bill and sec. 132 of the Code)

Present Law

HAP payment

The Department of Defense Homeowners Assistance Program ("HAP") provides payments to certain employees and members of the Armed Forces to offset the adverse effects on housing values that result from a military base realignment or closure. The payments are authorized under the provisions of Title 42 U.S.C. section 3374.

In general, under HAP, eligible individuals receive either (1) a cash payment as compensation for losses that may be or have been sustained in a private sale, in an amount not to exceed the difference between (a) 95 percent of the fair market value of their property prior to public announcement of intention to close all or part of the military base or installation and (b) the fair market value of such property at the time of the sale, or (2) as the purchase price for their property, an amount not to exceed 90 percent of the prior fair market value as determined by the Secretary of Defense, or the amount of the outstanding mortgages.

Tax treatment

Unless specifically excluded, gross income for Federal income tax purposes includes all income from whatever source derived. Amounts received under HAP are received in connection with the performance of services. These amounts are includible in gross income as compensation for services to the extent such payments exceed the fair market value of the property relinquished in exchange for such payments. Additionally, such payments are wages for Federal Insurance Contributions Act ("FICA") tax purposes (including Medicare).

Explanation of Provision

The bill generally exempts from gross income amounts received under the HAP (as in effect on the date of enactment of this bill). Amounts received under the program also are not considered wages for FICA tax purposes (including Medicare). The excludable amount is limited to the reduction in the fair market value of property.

Effective Date

The provision is effective for payments made after the date of enactment.

D. Expansion of Combat Zone Filing Rules to Contingency Operations (sec. 5 of the bill and sec. 7508 of the Code)

Present Law

General time limits for filing tax returns

Individuals generally must file their Federal income tax returns by April 15 of the year following the close of a taxable year. The Secretary may grant reasonable extensions of time for filing such returns. Treasury regulations provide an additional automatic two-month extension (until June 15 for calendar-year individuals) for United States citizens and residents in military or naval service on duty on April 15 of the following year (the otherwise applicable due date of the return) outside the United States. No action is necessary to apply for this extension, but taxpayers must indicate on their returns (when filed) that they are claiming this extension. Unlike most extensions of time to file, this extension applies to both filing returns and paying the tax due.

Treasury regulations also provide, upon application on the proper form, an automatic four-month extension (until August 15 for calendar-year individuals) for any individual timely filing that form and paying the amount of tax estimated to be due.

In general, individuals must make quarterly estimated tax payments by April 15, June 15, September 15, and January 15 of the following taxable year. Wage withholding is considered to be a payment of estimated taxes.

Suspension of time periods

In general, the period of time for performing various acts under the Code, such as filing tax returns, paying taxes, or filing a claim for credit or refund of tax, is suspended for any individual serving in the Armed Forces of the United States in an area designated as a "combat zone" during the period of combatant activities. An individual who becomes a prisoner of war is considered to continue in active service and is therefore also eligible for these suspension of time provisions. The suspension of time also applies to an individual serving in support of such Armed Forces in the combat zone, such as Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces in support of those Forces. The designation of a combat zone must be made by the President in an Executive Order. The President must also designate the period of combatant activities in the combat zone (the starting date and the termination date of combat).

The suspension of time encompasses the period of service in the combat zone during the period of combatant activities in the zone, as well as (1) any time of continuous qualified hospitalization resulting from injury received in the combat zone[2] or (2) time in missing in action status, plus the next 180 days.

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[2] Two special rules apply to continuous hospitalization inside the United States. First, the suspension of time provisions based on continuous hospitalization inside the United States are applicable only to the hospitalized individual; they are not applicable to the spouse of such

The suspension of time applies to the following acts:

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

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

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

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

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

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

(7) Assessment of any tax;

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

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

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

(11) Any other act required or permitted under the internal revenue laws specified by the Secretary of the Treasury.

Individuals may, if they choose, perform any of these acts during the period of suspension. Spouses of qualifying individuals are entitled to the same suspension of time, except that the spouse is ineligible for this suspension for any taxable year beginning more than two years after the date of termination of combatant activities in the combat zone.

Explanation of Provision

The bill applies the special suspension of time period rules to persons deployed outside the United States away from the individual's permanent duty station while participating in an operation designated by the Secretary of Defense as a contingency operation or that becomes a contingency operation. A contingency operation is defined[3] as a military operation that is

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individual. Second, in no event do the suspension of time provisions based on continuous hospitalization inside the United States extend beyond five years from the date the individual returns to the United States. These two special rules do not apply to continuous hospitalization outside the United States.

[3] The definition is by cross-reference to 10 U.S.C. 101.

designated by the Secretary of Defense as an operation in which members of the Armed Forces are or may become involved in military actions, operations, or hostilities against an enemy of the United States or against an opposing military force, or results in the call or order to (or retention of) active duty of members of the uniformed services during a war or a national emergency declared by the President or Congress.

Effective Date

The provision applies to any period for performing an act that has not expired before the date of enactment.

E. Modification of Membership Requirement for Exemption from Tax for Certain Veterans' Organizations (sec. 6 of the bill and sec. 501(c)(19) of the Code)

Present Law

Under present law, a veterans' organization as described in section 501(c)(19) of the Code generally is exempt from taxation. The Code defines such an organization as a post or organization of past or present members of the Armed Forces of the United States: (1) that is organized in the United States or any of its possessions; (2) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and (3) that meets certain membership requirements. The membership requirements are that (1) at least 75 percent of the organization's members are past or present members of the Armed Forces of the United States, and (2) substantially all of the remaining members are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets. No more than 2.5 percent of an organization's total members may consist of individuals who are not veterans, cadets, or spouses, widows, or widowers of such individuals.

Contributions to an organization described in section 501(c)(19) may be deductible for Federal income or gift tax purposes if the organization is a post or organization of war veterans.

Explanation of Provision

The bill permits ancestors or lineal descendants of past or present members of the Armed Forces of the United States or of cadets to qualify as members for purposes of the "substantially all" test. The bill does not change the requirement that 75 percent of the organization's members must be past or present members of the Armed Forces of the United States.

Effective Date

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

F. Clarification of Treatment of Certain Dependent Care Assistance Programs Provided to Members of the Uniformed Services of the United States (sec. 7 of the bill and sec. 134 of the Code)

Present Law

Present law provides that qualified military benefits are not included in gross income. Generally, a qualified military benefit is any allowance or in-kind benefit (other than personal use of a vehicle) which: (1) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services; and (2) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice which was in effect on such date. Generally, other than certain cost of living adjustments, no modification or adjustment of any qualified military benefit after September 9, 1986, is taken into account for purposes of this exclusion from gross income.

Explanation of Provision

The bill clarifies that dependent care assistance provided under a dependent care assistance program (as in effect on the date of enactment of this bill) for a member of the uniformed services by reason of such member's status or service as a member of the uniformed services is excludable from gross income as a qualified military benefit subject to the present-law rules. The uniformed services include: (1) the Armed Forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. Amounts received under the program also are not considered wages for Federal Insurance Contributions Act tax purposes (including Medicare).

Effective Date

The provision is effective for taxable years beginning after December 31, 2002. No inference is intended as to the tax treatment of such amounts for prior taxable years.

G. Treatment of Service Academy Appointments as Scholarships for Purposes of Qualified Tuition Programs and Coverdell Education Savings Accounts (sec. 8 of the bill and secs. 529 and 530 of the Code)

Present Law

The Code provides tax-exempt status to qualified tuition programs, meaning programs established and maintained by a State or agency or instrumentality thereof or by one or more eligible educational institutions under which a person (1) may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary, or (2) in the case of a program established by and maintained by a State or agency or instrumentality thereof, may make contributions to an account which is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account. Contributions to qualified tuition programs may be made only in cash. Qualified tuition programs must have adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of amounts necessary to provide for the qualified higher education expenses of the beneficiary.

The Code provides tax-exempt status to Coverdell education savings accounts ("ESAs"), meaning certain trusts or custodial accounts which are created or organized in the United States exclusively for the purpose of paying the qualified education expenses of a designated beneficiary. Contributions to ESAs may be made only in cash. Annual contributions to ESAs may not exceed $2,000 per beneficiary (except in cases involving certain tax-free rollovers) and may not be made after the designated beneficiary reaches age 18.

Earnings on contributions to an ESA or a qualified tuition program generally are subject to tax when withdrawn. However, distributions from an ESA or qualified tuition program are excludable from the gross income of the distributee to the extent that the total distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made.

If the qualified education expenses of the beneficiary for the year are less than the total amount of the distribution from an ESA or qualified tuition program, then the qualified education expenses are deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. In such a case, only a portion of the earnings is excludable (i.e., the portion of the earnings based on the ratio that the qualified education expenses bear to the total amount of the distribution) and the remaining portion of the earnings is includible in the beneficiary's gross income.

The earnings portion of a distribution from an ESA or a qualified tuition program that is includible in income is generally subject to an additional 10 percent tax. The 10 percent additional tax does not apply if a distribution is made on account of the death or disability of the designated beneficiary, or on account of a scholarship received by the designated beneficiary (to the extent it does not exceed the amount of the scholarship).

Service obligations are required of recipients of appointments to the United States Military Academy, the United States Naval Academy, the United States Air Force Academy, the United States Coast Guard Academy, or the United States Merchant Marine Academy. Because of these service obligations, appointments to the Academies are not considered scholarships for purposes of the waiver of the additional 10 percent tax on withdrawals from ESAs and qualified tuition programs that are not used for qualified education purposes.

Explanation of Provision

The bill permits penalty-free withdrawals from Coverdell education savings accounts and qualified tuition programs made on account of the attendance of the beneficiary at the United States Military Academy, the United States Naval Academy, the United States Air Force Academy, the United States Coast Guard Academy, or the United States Merchant Marine Academy.

The amount of funds that can be withdrawn penalty free is limited to the costs of advanced education as defined in 10 United States Code section 2005(e)(3) (as in effect on the date of the enactment of the bill) at such Academies.

Effective Date

The provision applies to taxable years beginning after December 31, 2002.

H. Above-the-Line Deduction for Overnight Travel Expenses of National Guard and Reserve Members (sec. 9 of the bill and sec. 162 of the Code)

Present Law

National Guard and Reserve members may claim itemized deductions for their nonreimbursable expenses for transportation, meals, and lodging when they must travel away from home (and stay overnight) to attend National Guard and Reserve meetings. These overnight travel expenses are combined with other miscellaneous itemized deductions on Schedule A of the individual's income tax return and are deductible only to the extent that the aggregate of these deductions exceeds two percent of the taxpayer's adjusted gross income. No deduction is generally permitted for commuting expenses to and from drill meetings.

Explanation of Provision

The bill provides an above-the-line deduction for the overnight transportation, meals, and lodging expenses of National Guard and Reserve members who must travel away from home more than 100 miles (and stay overnight) to attend National Guard and Reserve meetings. Accordingly, these individuals incurring these expenses can deduct them from gross income regardless of whether they itemize their deductions. The amount of the expenses that may be deducted may not exceed the general Federal Government per diem rate applicable to that locale. Also, the amount of the expenses that may be deducted may not exceed $1,500 per taxable year and is only available for any period during which the individual is more than 100 miles from home in connection with such services.

Effective Date

The provision is effective with respect to amounts paid or incurred after December 31, 2002.

I. Extension of Certain Tax Relief Provisions to Astronauts (sec. 10 of the bill and secs. 101, 692, and 2201 of the Code)

Present Law

In general

The Victims of Terrorism Tax Relief Act of 2001 (the "Victims Act") provided certain income and estate tax relief to individuals who die from wounds or injury incurred as a result of the terrorist attacks against the United States on September 11, 2001, and April 19, 1995 (the bombing of the Alfred P. Murrah Federal Building in Oklahoma City) or as a result of illness incurred due to an attack involving anthrax that occurred on or after September 11, 2001, and before January 1, 2002.

Income tax relief

The Victims Act extended relief similar to the present-law treatment of military or civilian employees of the United States who die as a result of terrorist or military activity outside the United States to individuals who die as a result of wounds or injury which were incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, and individuals who die as a result of illness incurred due to an attack involving anthrax that occurs on or after September 11, 2001, and before January 1, 2002. Under the Victims Act, such individuals generally are exempt from income tax for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury occurred.[4] The exemption applies to these individuals whether killed in an attack (e.g., in the case of the September 11, 2001, attack in one of the four airplanes or on the ground) or in rescue or recovery operations.

Present law provides a minimum tax relief benefit of $10,000 to each eligible individual regardless of the income tax liability of the individual for the eligible tax years. If an eligible individual's income tax for years eligible for the exclusion under the provision is less than $10,000, the individual is treated as having made a tax payment for such individual's last taxable year in an amount equal to the excess of $10,000 over the amount of tax not imposed under the provision.

Subject to rules prescribed by the Secretary, the exemption from tax does not apply to the tax attributable to (1) deferred compensation which would have been payable after death if the individual had died other than as a specified terrorist victim, or (2) amounts payable in the taxable year which would not have been payable in such taxable year but for an action taken after September 11, 2001. Thus, for example, the exemption does not apply to amounts payable from a qualified plan or individual retirement arrangement to the beneficiary or estate of the individual. Similarly, amounts payable only as death or survivor's benefits pursuant to deferred compensation preexisting arrangements that would have been paid if the death had occurred for another reason are not covered by the exemption. In addition, if the individual's employer makes adjustments to a plan or arrangement to accelerate the vesting of restricted property or the

[4] Present law does not provide relief from self-employment tax liability.

payment of nonqualified deferred compensation after the date of the particular attack, the exemption does not apply to income received as a result of that action.[5] Also, if the individual's beneficiary cashed in savings bonds of the decedent, the exemption does not apply. On the other hand, the exemption does apply, for example, to a final paycheck of the individual or dividends on stock held by the individual when paid to another person or the individual's estate after the date of death but before the end of the taxable year of the decedent (determined without regard to the death). The exemption also applies to payments of an individual's accrued vacation and accrued sick leave.

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

Exclusion of death benefits

The Victims Act generally provides an exclusion from gross income for amounts received if such amounts are paid by an employer (whether in a single sum or otherwise[6]) by reason of the death of an employee who dies as a result of wounds or injury which were incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, or as a result of illness incurred due to an attack involving anthrax that occured on or after September 11, 2001, and before January 1, 2002. Subject to rules prescribed by the Secretary, the exclusion does not apply to amounts that would have been payable if the individual had died for a reason other than the attack. The exclusion does apply, however, to death benefits provided under a qualified plan that satisfy the incidental benefit rule.

For purposes of the exclusion, self-employed individuals are treated as employees. Thus, for example, payments by a partnership to the surviving spouse of a partner who died as a result of the September 11, 2001 attacks may be excludable under the provision.

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

Estate tax relief

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

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[5] Such amounts may, however, be excludable from gross income under the death benefit exclusion provided in section 102 of the Victims Act.

[6] Thus, for example, payments made over a period of years could qualify for the exclusion.

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

Generally, the reduction in Federal estate taxes under section 2201 is equal in amount to the "additional estate tax." The additional estate tax is the difference between the Federal estate tax imposed by section 2001 and 125 percent of the maximum State death tax credit determined under section 2011(b) as in effect prior to its repeal by the Economic Growth and Tax Relief Reconciliation Act of 2001.

The Victims Act generally treats individuals who die from wounds or injury incurred as a result of the terrorist attacks that occurred on September 11, 2001, or April 19, 1995, or as a result of illness incurred due to an attack involving anthrax that occurred on or after September 11, 2001, and before January 1, 2002, in the same manner as if they were active members of the U.S. Armed Forces killed in action while serving in a combat zone or dying as a result of wounds or injury suffered while serving in a combat zone for purposes of section 2201. Consequently, the estates of these individuals are eligible for the reduction in Federal estate tax provided by section 2201. The tax relief does not apply to any individual identified by the Attorney General to have been a participant or conspirator in any terrorist attack to which the provision applies, or a representative of such individual.

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

Under the Victims Act, section 2201 no longer reduces Federal estate tax by the amount of the additional estate tax. Instead, the Victims Act provides that the Federal estate tax liability of eligible estates is determined under section 2001 (or section 2101, in the case of decedents who were neither residents nor citizens of the United States), using a rate schedule that is equal to 125 percent of the pre-EGTRRA maximum State death tax credit amount. This rate schedule is used to compute the tax under section 2001(b) or section 2101(b) (i.e., both the tentative tax under section 2001(b)(1) and section 2101(b), and the hypothetical gift tax under section 2001(b)(2) are computed using this rate schedule). As a result of this provision, the estate tax is unified with the gift tax for purposes of section 2201 so that a single graduated (but reduced) rate schedule applies to transfers made by the individual at death, based upon the cumulative taxable transfers made both during lifetime and at death.

In addition, while the Victims Act provides an alternative reduced rate table for purposes of determining the tax under section 2001(b) or section 2101(b), the amount of the unified credit nevertheless is determined as if section 2201 did not apply, based upon the unified credit as in effect on the date of death. For example, in the case of victims of the September 11, 2001, terrorist attack, the applicable unified credit amount under section 2010(c) would be determined by reference to the actual section 2001(c) rate table.

Explanation of Provision

The bill extends the exclusion from income tax, the exclusion for death benefits, and the estate tax relief available under the Victims of Terrorism Tax Relief Act of 2001 to astronauts who lose their lives on a space mission (including the individuals who lost their lives in the space shuttle Columbia disaster).

Effective Date

The provision is generally effective for qualified individuals whose lives are lost on a space mission after December 31, 2002.

J. No Impact on Social Security Trust Funds Under Title II of the Social Security Act (sec. 11 of the bill)

Present Law

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

Explanation of Provision

The bill provides that any amounts to be transferred to any trust fund under Title II of the Social Security Act are determined as if this bill has not been enacted. This will ensure that the income and balances of those Social Security trust funds are not reduced as a result of this bill.

Effective Date

The provision is effective on the date of enactment.

JOINT COMMITTEE ON TAXATION
April 9, 2003
JCX-38-03

ESTIMATED REVENUE EFFECTS OF H.R. 1664,
THE "ARMED FORCES TAX FAIRNESS ACT OF 2003"

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
Improving Tax Equity for Military Personnel														
1. Exclusion of gain on sale of a principal residence by a member of the uniformed and foreign services	soea 5/6/97	-65	-13	-14	-14	-15	-16	-16	-17	-17	-18	-19	-137	-224
2. Exclusion from gross income of certain death gratuity payments	doa 9/10/01	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-6	-10
3. Exclusion for amounts received under Department of Defense Homeowners Assistance Program	pma DOE	[1]	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	-11	-22
4. Expansion of combat zone filing rules to contingency operations	[2]	-9	[1]	[1]	[1]	[1]	-1	-1	-1	-1	-1	-1	-11	-14
5. Modification of membership requirement for exemption from tax for certain veterans' organizations	tyba DOE	-1	-1	-1	-1	-2	-2	-2	-2	-2	-2	-2	-8	-17
6. Clarification of treatment of certain dependent care assistance programs provided to members of the uniformed services of the United States	tyba 12/31/02	No Revenue Effect												
7. Treatment of service academy appointments as scholarships for purposes of qualified tuition programs and Coverdell Education Savings Accounts	tyba 12/31/02	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-1	-2
8. Above-the-line deduction of up to $1,500 for overnight travel expenses of National Guard and reserve members traveling more than 100 miles from home	apoia 12/31/02	-10	-52	-52	-53	-53	-54	-54	-55	-55	-56	-56	-272	-549
9. Tax relief and assistance for families of astronauts who lose their lives on a space mission	[3]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]
10. No impact on Social Security Trust Funds	DOE	No Revenue Effect												
NET TOTAL		**-86**	**-69**	**-70**	**-71**	**-73**	**-76**	**-76**	**-78**	**-78**	**-80**	**-81**	**-445**	**-839**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

apoia = amounts paid or incurred after
doa = deaths occurring after
DOE = date of enactment
pma = payments made after
soea = sales or exchanges after
tyba = taxable years beginning after
30da = 30 days after
90da = 90 days after

[1] Loss of less than $500,000.
[2] The provision applies to any period for performing an act that has not expired before the date of enactment.
[3] Generally effective for qualified individuals whose lives are lost on a space mission after December 31, 2002.