109TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
109–304

TAX RELIEF EXTENSION RECONCILIATION ACT OF 2005

NOVEMBER 17, 2005.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. THOMAS, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 4297]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4297) to provide for reconciliation pursuant to section 201(b) of the concurrent resolution on the budget for fiscal year 2006, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

CONTENTS

49–006

THE AMENDMENT

The amendment is as follows:
Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Relief Extension Reconciliation Act of 2005".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

TITLE I—EXTENSIONS OF CERTAIN PROVISIONS THROUGH 2006

SEC. 101. ALLOWANCE OF NONREFUNDABLE PERSONAL CREDITS AGAINST REGULAR AND MINIMUM TAX LIABILITY.

(a) IN GENERAL.—Paragraph (2) of section 26(a) (relating to special rule for taxable years 2000 through 2005) is amended—

(1) in the text by striking "or 2005" and inserting "2005, or 2006", and

(2) in the heading by striking "2005" and inserting "2006".

(b) CONFORMING PROVISIONS.—

(1) Subsection (i) of section 904 (relating to coordination with nonrefundable personal credits) is amended by striking "or 2005" and inserting "2005, or 2006".

(2) The amendments made by sections 201(b), 202(f), and 618(b) of the Economic Growth and Tax Relief Reconciliation Act of 2001 shall not apply to taxable years beginning during 2006.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2005.

SEC. 102. TAX INCENTIVES FOR BUSINESS ACTIVITIES ON INDIAN RESERVATIONS.

(a) INDIAN EMPLOYMENT TAX CREDIT.—

(1) IN GENERAL.—Subsection (f) of section 45A (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 2005.

(b) ACCELERATED DEPRECIATION FOR BUSINESS PROPERTY ON INDIAN RESERVATIONS.—

(1) IN GENERAL.—Paragraph (8) of section 168(j) (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply with respect to property placed in service after December 31, 2005.

SEC. 103. WORK OPPORTUNITY CREDIT.

(a) IN GENERAL.—Subparagraph (B) of section 51(c)(4) (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(b) INCREASE IN AGE LIMIT FOR FOOD STAMP RECIPIENTS.—Clause (i) of section 51(d)(8)(A) (relating to qualified food stamp recipient) is amended by striking "25" and inserting "35".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to individuals who begin work for the employer after December 31, 2005.

SEC. 104. WELFARE-TO-WORK CREDIT.

(a) IN GENERAL.—Subsection (f) of section 51A (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to individuals who begin work for the employer after December 31, 2005.

SEC. 105. DEDUCTION FOR CORPORATE DONATIONS OF COMPUTER TECHNOLOGY AND EQUIPMENT.

(a) IN GENERAL.—Subparagraph (G) of section 170(e)(6) (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to contributions made in taxable years beginning after December 31, 2005.

SEC. 106. AVAILABILITY OF MEDICAL SAVINGS ACCOUNTS.

(a) IN GENERAL.—Paragraphs (2) and (3)(B) of section 220(i) (defining cut-off year) are each amended by striking "2005" each place it appears in the text and headings and inserting "2006".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 220(j) is amended—

(A) in the text by striking "or 2004" each place it appears and inserting "2004, or 2005", and

(B) in the heading by striking "OR 2004" and inserting "2004, OR 2005".

(2) Subparagraph (A) of section 220(j)(4) is amended by striking "and 2004" and inserting "2004, and 2005".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

(d) TIME FOR FILING REPORTS, ETC.—

(1) The report required by section 220(j)(4) of the Internal Revenue Code of 1986 to be made on August 1, 2005, shall be treated as timely if made before the close of the 90-day period beginning on the date of the enactment of this Act.

(2) The determination and publication required by section 220(j)(5) of such Code with respect to calendar year 2005 shall be treated as timely if made before the close of the 120-day period beginning on the date of the enactment of this Act. If the determination under the preceding sentence is that 2005 is a cut-off year under section 220(i) of such Code, the cut-off date under such section 220(i) shall be the last day of such 120-day period.

SEC. 107. 15-YEAR COST RECOVERY FOR LEASEHOLD IMPROVEMENTS.

(a) IN GENERAL.—Clause (iv) of section 168(e)(3)(E) (relating to 15-year property) is amended by striking "January 1, 2006" and inserting "January 1, 2007".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to property placed in service after December 31, 2005.

SEC. 108. 15-YEAR COST RECOVERY FOR RESTAURANT IMPROVEMENTS.

(a) IN GENERAL.—Clause (v) of section 168(e)(3)(E) (relating to 15-year property) is amended by striking "January 1, 2006" and inserting "January 1, 2007".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to property placed in service after December 31, 2005.

SEC. 109. TAXABLE INCOME LIMIT ON PERCENTAGE DEPLETION FOR OIL AND NATURAL GAS PRODUCED FROM MARGINAL PROPERTIES.

(a) IN GENERAL.—Subparagraph (H) of section 613A(c)(6) (relating to oil and natural gas produced from marginal properties) is amended by striking "January 1, 2006" and inserting "January 1, 2007".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2005.

SEC. 110. DISTRICT OF COLUMBIA ENTERPRISE ZONE.

(a) PERIOD FOR WHICH DESIGNATION APPLICABLE.—Subsection (f) of section 1400 (relating to time for which designation applicable) is amended by striking "December 31, 2005" both places it appears and inserting "December 31, 2006".

(b) TAX-EXEMPT ECONOMIC DEVELOPMENT BONDS.—Subsection (b) of section 1400A (relating to period of applicability) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(c) ZERO PERCENT CAPITAL GAINS RATE.—

(1) IN GENERAL.—Subsection (b) of section 1400B (relating to DC Zone Asset) is amended by striking "January 1, 2006" each place it appears and inserting "January 1, 2007".

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (2) of section 1400B(e) (relating to gain before 1998 and after 2010 not qualified) is amended—

(i) by striking "December 31, 2010" and inserting "December 31, 2011", and

(ii) by striking "2010" in the heading and inserting "2011".

(B) Paragraph (2) of section 1400B(g) (relating to sales and exchanges of interests in partnerships and S corporations which are DC Zone businesses) is amended by striking "December 31, 2010" and inserting "December 31, 2011".

(C) Subsection (d) of section 1400F (relating to certain rules to apply) is amended by striking "December 31, 2010" and inserting "December 31, 2011".

(d) FIRST-TIME HOMEBUYER CREDIT FOR DISTRICT OF COLUMBIA.—Subsection (i) of section 1400C (relating to application of section) is amended by striking "January 1, 2006" and inserting "January 1, 2007".

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall take effect on January 1, 2006.

(2) TAX-EXEMPT ECONOMIC DEVELOPMENT BONDS.—The amendment made by subsection (b) shall apply to obligations issued after the date of the enactment of this Act.

SEC. 111. POSSESSION TAX CREDIT WITH RESPECT TO AMERICAN SAMOA.

(a) IN GENERAL.—Subparagraph (A) of section 936(j)(8) (relating to special rules for certain possessions) is amended by inserting before the period at the end the following: "(before January 1, 2007, in the case of American Samoa)".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2005.

SEC. 112. PARITY IN THE APPLICATION OF CERTAIN LIMITS TO MENTAL HEALTH BENEFITS.

(a) IN GENERAL.—Paragraph (3) of section 9812(f) (relating to application of section) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(b) EFFECTIVE DATES.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 113. RESEARCH CREDIT.

(a) EXTENSION.—

(1) IN GENERAL.—Subparagraph (B) of section 41(h)(1) (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(2) CONFORMING AMENDMENT.—Subparagraph (D) of section 45C(b)(1) (relating to special rule) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to amounts paid or incurred after December 31, 2005.

(b) INCREASE IN RATES OF ALTERNATIVE INCREMENTAL CREDIT.—

(1) IN GENERAL.—Subparagraph (A) of section 41(c)(4) (relating to election of alternative incremental credit) is amended—

(A) by striking "2.65 percent" and inserting "3 percent",

(B) by striking "3.2 percent" and inserting "4 percent", and

(C) by striking "3.75 percent" and inserting "5 percent".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years ending after the date of the enactment of this Act.

(c) ALTERNATIVE SIMPLIFIED CREDIT FOR QUALIFIED RESEARCH EXPENSES.—

(1) IN GENERAL.—Subsection (c) of section 41 (relating to base amount) is amended by redesignating paragraphs (5) and (6) as paragraphs (6) and (7), respectively, and by inserting after paragraph (4) the following new paragraph:

"(5) ELECTION OF ALTERNATIVE SIMPLIFIED CREDIT.—

"(A) IN GENERAL.—At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to 12 percent of so much of the qualified research expenses for the taxable year as exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

"(B) SPECIAL RULE IN CASE OF NO QUALIFIED RESEARCH EXPENSES IN ANY OF 3 PRECEDING TAXABLE YEARS.—

"(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The credit under this paragraph shall be determined under this subparagraph if the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined.

"(ii) CREDIT RATE.—The credit determined under this subparagraph shall be equal to 6 percent of the qualified research expenses for the taxable year.

"(C) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary. An election under this paragraph may not be made for any taxable year to which an election under paragraph (4) applies.".

(2) COORDINATION WITH ELECTION OF ALTERNATIVE INCREMENTAL CREDIT.—

(A) IN GENERAL.—Section 41(c)(4)(B) (relating to election) is amended by adding at the end the following: "An election under this paragraph may not be made for any taxable year to which an election under paragraph (5) applies.".

(B) TRANSITION RULE.—In the case of an election under section 41(c)(4) of the Internal Revenue Code of 1986 which applies to the taxable year which includes the date of the enactment of this Act, such election shall be treated as revoked with the consent of the Secretary of the Treasury if the taxpayer makes an election under section 41(c)(5) of such Code (as added by subsection (a)) for such year.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 114. QUALIFIED ZONE ACADEMY BONDS.

(a) IN GENERAL.—Paragraph (1) of section 1397E(e) (relating to national limit) is amended by striking "and 2005" and inserting "2005, and 2006".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued after December 31, 2005.

SEC. 115. CERTAIN EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS.

(a) IN GENERAL.—Subparagraph (D) of section 62(a)(2) (relating to certain expenses of elementary and secondary school teachers) is amended by striking "or 2005" and inserting "2005, or 2006".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to expenses paid or incurred in taxable years beginning after December 31, 2005.

SEC. 116. QUALIFIED TUITION AND RELATED EXPENSES.

(a) IN GENERAL.—Subsection (e) of section 222 (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2006".

(b) LIMITATIONS.—Paragraph (2) of section 222(b) (relating to applicable dollar limit) is amended by striking subparagraphs (A) and (B), by redesignating subparagraph (C) as subparagraph (B), and by inserting before subparagraph (B) (as so redesignated) the following:

"(A) 2006.—In the case of a taxable year beginning in 2006, the applicable dollar amount shall be equal to—

"(i) in the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), $4,000,

"(ii) in the case of a taxpayer not described in clause (i) whose adjusted gross income for the taxable year does not exceed $80,000 ($160,000 in the case of a joint return), $2,000, and "(iii) in the case of any other taxpayer, zero.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to payments made in taxable years beginning after December 31, 2005.

SEC. 117. STATE AND LOCAL GENERAL SALES TAXES.

(a) IN GENERAL.—Subparagraph (I) of section 164(b)(5) (relating to application of paragraph) is amended by striking "January 1, 2006" and inserting "January 1, 2007".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2005.

TITLE II—EXTENSIONS OF CERTAIN PROVISIONS FOR 2 ADDITIONAL YEARS AND OTHER MODIFICATIONS

SEC. 201. EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.

(a) EXTENSION OF TERMINATION DATE.—Subsection (h) of section 198 (relating to termination) is amended by striking "December 31, 2005" and inserting "December 31, 2007".

(b) PETROLEUM PRODUCTS TREATED AS HAZARDOUS SUBSTANCE.—Paragraph (1) of section 198(d) (relating to hazardous substance) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) any petroleum product (as defined in section 4612(a)(3)).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to expenditures paid or incurred after December 31, 2005.

SEC. 202. CONTROLLED FOREIGN CORPORATIONS.

(a) SUBPART F EXCEPTION FOR ACTIVE FINANCING.—

(1) EXEMPT INSURANCE INCOME.—Paragraph (10) of section 953(e) (relating to application) is amended—

(A) by striking "January 1, 2007" and inserting "January 1, 2009", and

(B) by striking "December 31, 2006" and inserting "December 31, 2008".

(2) EXCEPTION TO TREATMENT AS FOREIGN PERSONAL HOLDING COMPANY INCOME.—Paragraph (9) of section 954(h) (relating to application) is amended by striking "January 1, 2007" and inserting "January 1, 2009".

(b) LOOK-THROUGH TREATMENT OF PAYMENTS BETWEEN RELATED CONTROLLED FOREIGN CORPORATIONS UNDER THE FOREIGN PERSONAL HOLDING COMPANY RULES.—Subsection (c) of section 954 (relating to foreign personal holding company income) is amended by adding at the end the following new paragraph:

"(6) LOOK-THRU RULE FOR RELATED CONTROLLED FOREIGN CORPORATIONS.—

"(A) IN GENERAL.—For purposes of this subsection, dividends, interest, rents, and royalties received or accrued from a controlled foreign corporation which is a related person shall not be treated as foreign personal holding company income to the extent attributable or properly allocable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is not subpart F income. For purposes of this subparagraph, interest shall include factoring income which is treated as income equivalent to interest for purposes of paragraph (1)(E). The Secretary shall prescribe such regulations as may be appropriate to prevent the abuse of the purposes of this paragraph.

"(B) APPLICATION.—Subparagraph (A) shall apply to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2009, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.".

SEC. 203. CAPITAL GAINS AND DIVIDENDS RATES.

Section 303 of the Jobs and Growth Tax Relief Reconciliation Act of 2003 is amended by striking "December 31, 2008" and inserting "December 31, 2010".

SEC. 204. SAVER'S CREDIT.

Subsection (h) of section 25B (relating to elective deferrals and IRA contributions by certain individuals) is amended by striking "December 31, 2006" and inserting "December 31, 2008".

SEC. 205. INCREASED EXPENSING FOR SMALL BUSINESS.

Subsections (b)(1), (b)(2), (b)(5), (c)(2), and (d)(1)(A)(ii) of section 179(b) (relating to election to expense certain depreciable business assets) are each amended by striking "2008" and inserting "2010".

TITLE III—OTHER PROVISIONS

SEC. 301. CLARIFICATION OF TAXATION OF CERTAIN SETTLEMENT FUNDS.

(a) IN GENERAL.—Subsection (g) of section 468B (relating to clarification of taxation of certain funds) is amended to read as follows:

"(g) CLARIFICATION OF TAXATION OF CERTAIN FUNDS.—

"(1) IN GENERAL.—Except as provided in paragraph (2), nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

"(2) EXEMPTION FROM TAX FOR CERTAIN SETTLEMENT FUNDS.—An escrow account, settlement fund, or similar fund shall be treated as beneficially owned by the United States and shall be exempt from taxation under this subtitle if—

"(A) it is established pursuant to a consent decree entered by a judge of a United States District Court,

"(B) it is created for the receipt of settlement payments as directed by a government entity for the sole purpose of resolving or satisfying one or more claims asserting liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980,

"(C) the authority and control over the expenditure of funds therein (including the expenditure of contributions thereto and any net earnings thereon) is with such government entity, and

"(D) upon termination, any remaining funds will be disbursed to such government entity for use in accordance with applicable law.

For purposes of this paragraph, the term 'government entity' means the United States, any State or political subdivision thereof, the District of Columbia, any possession of the United States, and any agency or instrumentality of any of the foregoing.

"(3) TERMINATION.—Paragraph (2) shall not apply to accounts and funds established after December 31, 2010.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to accounts and funds established after the date of the enactment of this Act.

SEC. 302. MODIFICATION OF ACTIVE BUSINESS DEFINITION UNDER SECTION 355.

Subsection (b) of section 355 (defining active conduct of a trade or business) is amended by adding at the end the following new paragraph:

"(3) SPECIAL RULE RELATING TO ACTIVE BUSINESS REQUIREMENT.—

"(A) IN GENERAL.—In the case of any distribution made after the date of the enactment of this paragraph and before December 31, 2010, a corporation shall be treated as meeting the requirement of paragraph (2)(A) if and only if such corporation is engaged in the active conduct of a trade or business.

"(B) AFFILIATED GROUP RULE.—For purposes of subparagraph (A), all members of such corporation's separate affiliated group shall be treated as one corporation. For purposes of the preceding sentence, a corporation's separate affiliated group is the affiliated group which would be determined under section 1504(a) if such corporation were the common parent and section 1504(b) did not apply.

"(C) TRANSITION RULE.—Subparagraph (A) shall not apply to any distribution pursuant to a transaction which is—

"(i) made pursuant to an agreement which was binding on the date of the enactment of this paragraph and at all times thereafter,

"(ii) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

"(iii) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission.

The preceding sentence shall not apply if the distributing corporation elects not to have such sentence apply to distributions of such corporation. Any such election, once made, shall be irrevocable.

"(D) SPECIAL RULE FOR CERTAIN PRE-ENACTMENT DISTRIBUTIONS.—For purposes of determining the continued qualification under paragraph (2)(A) of distributions made before the date of the enactment of this paragraph as a result of an acquisition, disposition, or other restructuring after such date and before December 31, 2010, such distribution shall be treated as made after the date of the enactment of this paragraph for purposes of applying subparagraphs (A) through (C) of this paragraph.".

SEC. 303. VETERANS' MORTGAGE BONDS.

(a) ALL VETERANS ELIGIBLE FOR STATE HOME LOAN PROGRAMS FUNDED BY QUALIFIED VETERANS' MORTGAGE BONDS.—

(1) IN GENERAL.—Paragraph (4) of section 143(l) (defining qualified veteran) is amended—

(A) by striking "at some time before January 1, 1977" in subparagraph (A), and

(B) by striking subparagraph (B) and inserting the following:

"(B) who applied for the financing before the date 25 years after the last date on which such veteran left active service.".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to financing provided after the date of the enactment of this Act.

(b) REVISION OF STATE VETERANS LIMIT.—

(1) IN GENERAL.—Subparagraph (B) of section 143(l)(3) (relating to volume limitation) is amended to read as follows:

"(B) STATE VETERANS LIMIT.—

"(i) IN GENERAL.—A State veterans limit for any calendar year is the amount equal to—

"(I) $53,750,000 for the State of Texas,

"(II) $66,250,000 for the State of California,

"(III) $25,000,000 for the State of Oregon,

"(IV) $25,000,000 for the State of Wisconsin, and

"(V) $25,000,000 for the State of Alaska.

"(ii) PHASEIN.—In the case of calendar years beginning before 2010, clause (i) shall be applied by substituting for each of the dollar amounts therein by the applicable percentage. For purposes of the preceding sentence, the applicable percentage shall be determined in accordance with the following table:

"Calendar Year:	Applicable percentage is:
2006	20 percent
2007	40 percent
2008	60 percent
2009	80 percent.

"(iii) TERMINATION.—The State veterans limit for any calendar year after 2010 is zero.".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to bonds issued after December 31, 2005.

SEC. 304. CAPITAL GAINS TREATMENT FOR CERTAIN SELF-CREATED MUSICAL WORKS.

(a) IN GENERAL.—Subsection (b) of section 1221 (relating to capital asset defined) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) SALE OR EXCHANGE OF SELF-CREATED MUSICAL WORKS.—At the election of the taxpayer, paragraphs (1) and (3) of subsection (a) shall not apply with respect to any sale or exchange before January 1, 2011, of musical compositions or copyrights in musical works by a taxpayer described in subsection (a)(3).".

(b) LIMITATION ON CHARITABLE CONTRIBUTIONS.—Subparagraph (A) of section 170(e)(1) is amended by inserting "(determined without regard to section 1221(b)(3))" after "long-term capital gain".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales and exchanges in taxable years beginning after the date of the enactment of this Act.

SEC. 305. VESSEL TONNAGE LIMIT.

(a) IN GENERAL.—Paragraph (4) of section 1355(a) (relating to qualifying vessel) is amended by inserting "(6,000, in the case of taxable years beginning after December 31, 2005, and ending before January 1, 2011)" after "10,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2005.

SEC. 306. MODIFICATION OF SPECIAL ARBITRAGE RULE FOR CERTAIN FUNDS.

In the case of bonds issued after the date of the enactment of this Act and before August 31, 2009—

(1) the requirement of paragraph (1) of section 648 of the Deficit Reduction Act of 1984 (98 Stat. 941) shall be treated as met with respect to the securities or obligations referred to in such section if such securities or obligations are held in a fund the annual distributions from which cannot exceed 7 percent of the average fair market value of the assets held in such fund except to the extent distributions are necessary to pay debt service on the bond issue, and

(2) paragraph (3) of such section shall be applied by substituting "distributions from" for "the investment earnings of" both places it appears.

II. SUMMARY AND BACKGROUND

A. Purpose and Summary

The bill, H.R. 4297, as amended, provides for reconciliation pursuant to section 201(b) of the concurrent resolution on the budget for fiscal year 2006. The bill: (1) extends certain expiring provisions through 2006; (2) extends certain provisions for two additional years, and other modifications; and (3) makes other modifications to the tax laws.

Extension of certain expiring provisions through 2006

The bill extends for one year, through December 31, 2006, the following provisions:

- allowance of nonrefundable personal credits against the alternative minimum tax;
- tax incentives for business activities on Indian reservations;
- the work opportunity tax credit (and increases the age limit for food stamp recipients from 25 to 35);
- the welfare-to-work tax credit;
- the enhanced deduction for corporate donations of computer technology and equipment;
- the availability of Archer medical savings accounts;
- fifteen-year cost recovery for leasehold improvements;
- fifteen-year cost recovery for restaurant improvements;
- suspension of taxable income limit on percentage depletion for oil and natural gas produced from marginal wells;
- tax incentives for the District of Columbia Enterprise Zone;
- possession tax credit with respect to American Samoa;
- excise tax provisions relating to mental health parity rules;
- an expanded research and experimentation credit;
- authority to issue qualified zone academy bonds;
- the deduction for teacher classroom expenses;
- the deduction for qualified tuition and related expenses; and
- the deduction for State and local sales taxes.

Extension of certain provisions for two additional years and other modifications

The bill extends and modifies certain other provisions, as follows:

- Expensing of "brownfield" environmental clean up costs is extended for two years through 2007 (and expanded to include sites contaminated by petroleum products);

- The subpart F active financing exception is extended for two years, though 2008;
- Look-through treatment is provided (through 2008) under the subpart F foreign personal holding company income rules for certain payments between related foreign subsidiaries;
- The zero- and 15-percent rates on capital gains and dividend income are extended for two years, through 2010;
- The saver's credit is extended for two years, though December 31, 2008; and
- Enhanced section 179 expensing for small businesses is extended for two years, through 2009.

Other provisions

The bill contains other provisions, as follows:

- Certain settlement funds established after the date of enactment and on or before December 31, 2010, for the cleanup of hazardous waste sites are not subject to Federal income tax;
- The active business definition under section 355 is modified;
- The qualified veterans' mortgage bond program is expanded to include more recent veterans, effective for financing provided after the date of enactment. In addition, new volume caps are provided for veteran's mortgage bonds for States eligible to issue such bonds, effective for bonds issued after December 31, 2005;
- Capital gain treatment is provided to songwriters' sales of their musical compositions or copyrights in those compositions. This treatment applies to sales or exchanges (1) in taxable years beginning after the date of enactment and (2) before January 1, 2011;
- The minimum weight for vessels eligible for the tonnage tax regime is decreased to 6,000 deadweight tons through December 31, 2010; and
- The modification of a special arbitrage rule for a certain fund is extended through August 31, 2009.

B. Background and Need for Legislation

Under the Concurrent Resolution on the Budget for Fiscal Year 2006, the Committee on Ways and Means was instructed to report revenue reconciliation provisions sufficient to reduce revenues by not more than $11 billion for fiscal year 2006 and by not more than $70 billion for the period of fiscal years 2006 through 2010. The instructions further provide that revenues are not to be reduced by more than $60 billion for the period of fiscal years 2006 through 2010 prior to action on the spending reconciliation provisions. The reconciliation provisions approved by the Committee reflect the need to avoid tax increases on families and business as a result of provisions that would otherwise expire, as well as other purposes.

C. Legislative History

The Committee marked up the bill on November 15, 2005, and ordered the bill, as amended, favorably reported.

The Committee held the following hearings relating to the bill:

• Hearing on the President's fiscal year 2006 budget with OMB Director Bolton (Feb. 9, 2005); and
• Hearing on the President's fiscal year 2006 budget with Treasury Secretary Snow (Feb. 8, 2005).

III. EXPLANATION OF THE BILL

TITLE I—EXTENSIONS OF CERTAIN PROVISIONS THROUGH 2006

A. ALLOWANCE OF NONREFUNDABLE PERSONAL CREDITS AGAINST REGULAR AND ALTERNATIVE MINIMUM TAX LIABILITY

(sec. 101 of the bill and sec. 26 of the Code)

PRESENT LAW

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, and the D.C. first-time homebuyer credit).

For taxable years beginning in 2005, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

For taxable years beginning after 2005, the nonrefundable personal credits (other than the adoption credit, child credit and saver's credit) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, child credit, and saver's credit are allowed to the full extent of the individual's regular tax and alternative minimum tax.

The alternative minimum tax is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The exemption amount is: (1) $45,000 ($58,000 for taxable years beginning before 2006) in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 ($40,250 for taxable years beginning before 2006) in the case of other unmarried individuals; (3) $22,500 ($29,000 for taxable years beginning before 2006) in the case of married individuals filing a separate return; and (4) $22,500 in the case of an estate or trust. The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns, an estate, or a trust. These amounts are not indexed for inflation.

REASONS FOR CHANGE

The Committee believes that the nonrefundable personal credits should be useable without limitation by reason of the alternative minimum tax.

EXPLANATION OF PROVISION

The provision extends for one year the present-law provision allowing nonrefundable personal credits to the full extent of the individual's regular tax and alternative minimum tax (through taxable years beginning on or before December 31, 2006).

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2005.

B. Tax Incentives for Business Activities on Indian Reservations

1. Indian employment tax credit (sec. 102(a) of the bill and sec. 45A of the Code)

PRESENT LAW

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees (sec. 45A). The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An "Indian reservation" is a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(1) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (which after adjusted for inflation after 1993 is currently $35,000). In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a 5 percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee's services relate to gaming activities or are performed in a building housing such activities.

The wage credit is available for wages paid or incurred on or after January 1, 1994, in taxable years that begin before January 1, 2006.

REASONS FOR CHANGE

The Committee believes that extending the wage credit tax incentive will expand employment opportunities for members of Indian tribes.

EXPLANATION OF PROVISION

The provision extends for one year the present-law employment credit provision (through taxable years beginning on or before December 31, 2006).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2005.

2. Accelerated depreciation for business property on Indian reservations (sec. 102(b) of the bill and sec. 168(j) of the Code)

PRESENT LAW

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

	Years
3-year property	2
5-year property	3
7-year property	4
10-year property	6
15-year property	9
20-year property	12
Nonresidential real property	22

"Qualified Indian reservation property" eligible for accelerated depreciation includes property which is (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation, (2) not used or located outside the reservation on a regular basis, (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer (within the meaning of section 465(b)(3)(C)), and (4) described in the recovery-period table above. In addition, property is not "qualified Indian reservation property" if it is placed in service for purposes of conducting gaming activities. Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).

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

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for Indian reservations is available with respect to property placed in service on or after January 1, 1994, and before January 1, 2006.

REASONS FOR CHANGE

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

EXPLANATION OF PROVISION

The provision extends for one year the present-law incentive relating to depreciation of qualified Indian reservation property (to apply to property placed in service through December 31, 2006).

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2005.

C. WORK OPPORTUNITY TAX CREDIT

(sec. 103 of the bill and sec. 51 of the Code)

PRESENT LAW

Work opportunity tax credit

Targeted groups eligible for the credit

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The eight targeted groups are: (1) certain families eligible to receive benefits under the Temporary Assistance for Needy Families Program; (2) high-risk youth; (3) qualified ex-felons; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; (7) families receiving food stamps; and

(8) persons receiving certain Supplemental Security Income (SSI) benefits.

A high-risk youth is an individual aged at least 18 but aged under 25 on the hiring date who is certified by a designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community. The credit is not available if the youth's principal place of abode ceases to be within an empowerment zone, enterprise community, or renewal community.

A qualified ex-felon is an individual certified by a designated local agency as: (1) having been convicted of a felony under State or Federal law; (2) being a member of an economically disadvantaged family; and (3) having a hiring date within one year of release from prison or conviction.

A food stamp recipient is an individual aged at least 18 but aged under 25 on the hiring date certified by a designated local agency as being a member of a family either currently or recently receiving assistance under an eligible food stamp program.

Qualified wages

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

Calculation of the credit

The credit equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages).

Minimum employment period

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

Coordination of the work opportunity tax credit and the welfare-to-work tax credit

An employer cannot claim the work opportunity tax credit with respect to wages of any employee on which the employer claims the welfare-to-work tax credit.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. Similarity wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2005.

REASONS FOR CHANGE

The Committee believes that the extension will continue to lower barriers to employment for the enumerated disadvantaged target groups while at the same time provide Congress and the Treasury Department and Labor Department with an opportunity to study the efficacy, the operation, and the effectiveness of the credit.

EXPLANATION OF PROVISION

In general

The bill extends the work opportunity credit for one year (through December 31, 2006).

Targeted groups eligible for the combined credit

The bill raises the maximum age limit for the food stamp recipient category to include individuals who are at least age 18 but under age 35 on the hiring date.

EFFECTIVE DATE

The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer after December 31, 2005, and before January 1, 2007.

D. Welfare-to-Work Tax Credit

(sec. 104 of the bill and sec. 51A of the Code)

PRESENT LAW

Welfare-to-work tax credit

Targeted group eligible for the credit

The welfare-to-work tax credit is available on an elective basis to employers of qualified long-term family assistance recipients. Qualified long-term family assistance recipients are: (1) members of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit) if they are hired within two years after the date that the 18-month total is reached; and (3) members of a family who are no longer eligible for family assistance because of either Federal or State time limits, if they are hired within two years after the Federal or State time limits made the family ineligible for family assistance.

Qualified wages

Qualified wages for purposes of the welfare-to-work tax credit are defined more broadly than the work opportunity tax credit. Unlike the definition of wages for the work opportunity tax credit which includes simply cash wages, the definition of wages for the welfare-to-work tax credit includes cash wages paid to an employee plus amounts paid by the employer for: (1) educational assistance excludable under a section 127 program (or that would be excludable but for the expiration of sec. 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129. The employer's deduction for wages is reduced by the amount of the credit.

Calculation of the credit

The welfare-to-work tax credit is available on an elective basis to employers of qualified long-term family assistance recipients during the first two years of employment. The maximum credit is 35 percent of the first $10,000 of qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Qualified first-year wages are defined as qualified wages (not in excess of $10,000) attributable to service rendered by a member of the targeted group during the one-year period beginning with the day the individual began work for the employer. Qualified second-year wages are defined as qualified wages (not in excess of $10,000) attributable to service rendered by a member of the targeted group during the one-year period beginning immediately after the first year of that individual's employment for the employer. The maximum credit is $8,500 per qualified employee.

Minimum employment period

No credit is allowed for qualified wages paid to a member of the targeted group unless they work at least 400 hours or 180 days in the first year of employment.

Coordination of the work opportunity tax credit and the welfare-to-work tax credit

An employer cannot claim the work opportunity tax credit with respect to wages of any employee on which the employer claims the welfare-to-work tax credit.

Other rules

The welfare-to-work tax credit incorporates directly or by reference many of the other rules contained on the work opportunity tax credit.

Expiration

The welfare-to-work credit is not available for individuals who begin work for an employer after December 31, 2005.

REASONS FOR CHANGE

The Committee believes that the extension will continue to lower barriers to employment for the enumerated disadvantaged target groups while at the same time provide Congress and the Treasury Department and Labor Department with an opportunity to study the efficacy, the operation, and the effectiveness of the credit.

EXPLANATION OF PROVISION

The bill extends the welfare-to-work tax credit for one year (through December 31, 2006).

EFFECTIVE DATE

The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer after December 31, 2005, and before January 1, 2007.

E. DEDUCTION FOR CORPORATE DONATIONS OF COMPUTER TECHNOLOGY AND EQUIPMENT

(sec. 105 of the bill and sec. 170 of the Code)

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.

Under present law, a taxpayer's deduction for charitable 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 computer contribution." This enhanced deduction is equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one half of fair market value 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, 2005.

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 substantially completed. The original use of the property must be by the donor or the donee, 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. That is, 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) does not exceed 50 percent of the taxpayer's basis in the property. Contributions may be made to private foundations under certain conditions.

REASONS FOR CHANGE

The Committee believes that educational organizations and public libraries continue to have a need for computer equipment and that it is appropriate to extend the enhanced deduction for contributions of such equipment to such institutions.

EXPLANATION OF PROVISION

The provision extends for one year the present-law provision relating to qualified computer contributions (to apply to contributions made in taxable years beginning on or before December 31, 2006).

EFFECTIVE DATE

The provision applies to contributions made in taxable years beginning after December 31, 2005.

F. Availability of Archer Medical Savings Accounts

(sec. 106 of the bill and sec. 220 of the Code)

PRESENT LAW

Archer medical savings accounts

In general

Within limits, contributions to an Archer medical savings account ("Archer MSA") are deductible in determining adjusted gross income if made by an eligible individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an eligible individual. Earnings on amounts in an Archer MSA are not currently taxable. Distributions from an Archer MSA for medical expenses are not includible in gross income. Distributions not used for medical expenses are includible in gross income. In addition, distributions not used for medical expenses are subject to an additional 15-percent tax unless the distribution is made after age 65, death, or disability.

Eligible individuals

Archer MSAs are available to employees covered under an employer-sponsored high deductible plan of a small employer and self-employed individuals covered under a high deductible health plan. An employer is a small employer if it employed, on average, no more than 50 employees on business days during either the preceding or the second preceding year. An individual is not eligible for an Archer MSA if he or she is covered under any other health plan in addition to the high deductible plan.

Tax treatment of and limits on contributions

Individual contributions to an Archer MSA are deductible (within limits) in determining adjusted gross income (i.e., "above-the-line"). In addition, employer contributions are excludable from gross income and wages for employment tax purposes (within the same limits), except that this exclusion does not apply to contributions made through a cafeteria plan. In the case of an employee, contributions can be made to an Archer MSA either by the individual or by the individual's employer.

The maximum annual contribution that can be made to an Archer MSA for a year is 65 percent of the deductible under the high deductible plan in the case of individual coverage and 75 percent of the deductible in the case of family coverage.

Definition of high deductible plan

A high deductible plan is a health plan with an annual deductible of at least $1,750 and no more than $2,650 in the case of individual coverage and at least $3,500 and no more than $5,250 in the case of family coverage (for 2005). In addition, the maximum out-of-pocket expenses with respect to allowed costs (including the deductible) must be no more than $3,500 in the case of individual coverage and no more than $6,450 in the case of family coverage (for 2005). A plan does not fail to qualify as a high deductible plan merely because it does not have a deductible for preventive care as required by State law. A plan does not qualify as a high deductible health plan if substantially all of the coverage under the plan is for certain permitted coverage. In the case of a self-insured plan, the plan must in fact be insurance (e.g., there must be appropriate risk shifting) and not merely a reimbursement arrangement.

Cap on taxpayers utilizing Archer MSAs and expiration of pilot program

The number of taxpayers benefiting annually from an Archer MSA contribution is limited to a threshold level (generally 750,000 taxpayers). The number of Archer MSAs established has not exceeded the threshold level.

After 2005, no new contributions may be made to Archer MSAs except by or on behalf of individuals who previously made (or had made on their behalf) Archer MSA contributions and employees who are employed by a participating employer.

Trustees of Archer MSAs are generally required to make reports to the Treasury by August 1 regarding Archer MSAs established by July 1 of that year. If the threshold level is reached in a year, the Secretary is required to make and publish such determination by October 1 of such year.

Health savings accounts

Health savings accounts ("HSAs") were enacted by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. Like Archer MSAs, an HSA is a tax-exempt trust or custodial account to which tax-deductible contributions may be made by individuals with a high deductible health plan. HSAs provide tax benefits similar to, but more favorable than, those provide by Archer MSAs. HSAs were established on a permanent basis.

REASONS FOR CHANGE

The Committee believes that individuals should be encouraged to save for future medical care expenses and that individuals should be allowed to save for such expenses on a tax-favored basis. The Committee believes that consumers who spend their own savings on health care will make cost-conscious decisions, thus reducing the rising cost of health care. The Committee believes that Archer

MSAs have been an important tool in allowing certain individuals to save for future medical expenses on a tax-favored basis.

The Committee is aware that recently enacted health savings accounts (HSAs) offer more advantageous tax treatment than Archer MSAs and that amounts can be rolled over into a health savings account from an Archer MSA on a tax-free basis. The Committee recognizes that the transition from MSAs to HSAs is still in progress and thus believes an extension of MSAs is appropriate.

The Committee is also aware that taxpayers in some States cannot take advantage of MSAs or HSAs because some State law bars offering high deductible plans and in other cases, State tax law may undermine the advantages of such accounts for many savers. Such barriers limit consumer acceptance of these health care savings vehicles, which now have over one million participants, many of whom either had no insurance or worked for small businesses unable to offer health coverage. Because of the potential benefits of these savings vehicles and particularly those of HSAs, the Committee would encourage States to reconsider prohibitions on high deductible plans and State tax policies so that more Americans would have the option of preparing for health care needs through a savings plan.

EXPLANATION OF PROVISION

The provision extends for one year the present-law Archer MSA provisions (through December 31, 2006).

The report required by Archer MSA trustees is treated as timely filed if made before the close of the 90–day period beginning on the date of enactment. The determination and publication whether the threshold level has been exceeded is treated as timely if made before the close of the 120-day period beginning on the date of enactment.

EFFECTIVE DATE

The provision is effective on the date of enactment.

G. FIFTEEN-YEAR STRAIGHT-LINE COST RECOVERY FOR QUALIFIED LEASEHOLD IMPROVEMENTS AND QUALIFIED RESTAURANT IMPROVEMENTS

(secs. 107 and 108 of the bill and sec. 168(e)(3)(E) of the Code)

PRESENT LAW

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-inservice conventions, and depreciation methods to the cost of various types of depreciable property.[1] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month

[1] Sec. 168.

placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements and certain qualified restaurant property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2006. Qualified leasehold improvement property is recovered using the straight-line method. Leasehold improvements placed in service in 2006 and later will be subject to the general rules described above.

Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building. However, if a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for nonrecognition treatment.

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2006. For purposes of the provision, qualified restaurant property means any improvement to a building if such improvement is placed in service more than three years after the date such building was first placed in service and more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals. Qualified restaurant property is recovered using the straight-line method.

REASONS FOR CHANGE

Although lease terms differ, the Committee believes that lease terms for commercial real estate typically are shorter than a 39-year recovery period. In the interests of simplicity and administrability, a uniform period for recovery of leasehold improvements is desirable. The Committee bill therefore extends the present-law provision allowing taxpayers to use a recovery period for leasehold improvements of a more realistic 15 years.

The Committee also believes that restaurant buildings generally are more specialized structures than other commercial buildings. The Committee believes that the present-law provision allowing taxpayers to use a 15-year recovery period for improvements made to restaurant buildings more accurately reflects the economic life of the properties than a 39-year recovery period.

EXPLANATION OF PROVISION

The provision extends for one year the present-law provisions providing a 15-year recovery period for qualified leasehold improvement property and for qualified restaurant property (to apply to property placed in service through December 31, 2006).

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2005.

H. Taxable Income Limit on Percentage Depletion for Oil and Natural Gas Produced from Marginal Properties

(sec. 109 of the bill and sec. 613A(c)(6)(H) of the Code)

Present Law

The Code permits taxpayers to recover their investments in oil and gas wells through depletion deductions. Two methods of depletion are currently allowable under the Code: (1) the cost depletion method, and (2) the percentage depletion method. Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the depletable property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining as of the end of the taxable year plus the number of units sold during the taxable year. Thus, the amount recovered under cost depletion may never exceed the taxpayer's basis in the property.

The Code generally limits the percentage depletion method for oil and gas properties to independent producers and royalty owners. Generally, under the percentage depletion method, 15 percent of the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year. The amount deducted generally may not exceed 100 percent of the taxable income from that property in any year. For marginal production, the 100-percent taxable income limitation has been suspended for taxable years beginning after December 31, 1997, and before January 1, 2006.

Marginal production is defined as domestic crude oil and natural gas production from stripper well property or from property substantially all of the production from which during the calendar year is heavy oil. Stripper well property is property from which the average daily production is 15 barrel equivalents or less, determined by dividing the average daily production of domestic crude oil and domestic natural gas from producing wells on the property for the calendar year by the number of wells. Heavy oil is domestic crude oil with a weighted average gravity of 20 degrees API or less (corrected to 60 degrees Fahrenheit).

REASONS FOR CHANGE

Domestic production from marginal wells is an appropriate part of establishing national energy security and reducing dependence on foreign oil. The Committee believes the suspension of the 100-percent taxable income limitation for marginal wells should be extended to encourage continued operation of such wells.

EXPLANATION OF PROVISION

The provision extends for one year the present-law taxable income limitation suspension provision for marginal production (through taxable years beginning on or before December 31, 2006).

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2005.

I. TAX INCENTIVES FOR INVESTMENT IN THE DISTRICT OF COLUMBIA

(sec. 110 of the bill and secs. 1400, 1400A, 1400B, and 1400C of the Code)

PRESENT LAW IN GENERAL

The Taxpayer Relief Act of 1997 designated certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone (the "D.C. Zone"), within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Zone are (1) all census tracts that presently are part of the D.C. enterprise community designated under section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District), and (2) all additional census tracts within the District of Columbia where the poverty rate is not less than 20 percent. The D.C. Zone designation remains in effect for the period from January 1, 1998, through December 31, 2005. In general, the tax incentives available in connection with the D.C. Zone are a 20-percent wage credit, an additional $35,000 of section 179 expensing for qualified zone property, expanded tax-exempt financing for certain zone facilities, and a zero-percent capital gains rate from the sale of certain qualified D.C. zone assets.

Wage credit

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

Wages paid to a qualified employee who earns more than $15,000 are eligible for the wage credit (although only the first $15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the D.C. Zone may claim the wage credit, regardless of whether the employer meets the definition of a "D.C. Zone business."[2]

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[3] Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under section 51 or the welfare-to-work credit under section 51A.[4] In addition, the $15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.[5] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[6]

Section 179 expensing

In general, a D.C. Zone business is allowed an additional $35,000 of section 179 expensing for qualifying property placed in service by a D.C. Zone business.[7] The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds $200,000 ($400,000 for taxable years beginning after 2002 and before 2008). The term "qualified zone property" is defined as depreciable tangible property (including buildings), provided that (1) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (2) the original use of the property in the D.C. Zone commences with the taxpayer, and (3) substantially all of the use of the property is in the D.C. Zone in the active conduct of a trade or business by the taxpayer.[8] Special rules are provided in the case of property that is substantially renovated by the taxpayer.

Tax-exempt financing

A qualified D.C. Zone business is permitted to borrow proceeds from tax-exempt qualified enterprise zone facility bonds (as defined in section 1394) issued by the District of Columbia.[9] Generally, qualified enterprise zone facility bonds for the District of Columbia are bonds 95 percent or more of the net proceeds of which are used

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[2] However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B) or certain farming activities. In addition, wages are not eligible for the wage credit if paid to (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

[3] Sec. 280C(a).

[4] Secs. 1400H(a), 1396(c)(3)(A) and 51A(d)(2).

[5] Secs. 1400H(a), 1396(c)(3)(B) and 51A(d)(2).

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

[7] Sec. 1397A.

[8] Sec. 1397D.

[9] Sec. 1400A.

to finance certain facilities within the D.C. Zone. The aggregate face amount of all outstanding qualified enterprise zone facility bonds per qualified D.C. Zone business may not exceed $15 million and may be issued only while the D.C. Zone designation is in effect.

Zero-percent capital gains

A zero-percent capital gains rate applies to capital gains from the sale of certain qualified D.C. Zone assets held for more than five years.[10] In general, a qualified "D.C. Zone asset" means stock or partnership interests held in, or tangible property held by, a D.C. Zone business. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent.

In general, gain eligible for the zero-percent tax rate means gain from the sale or exchange of a qualified D.C. Zone asset that is (1) a capital asset or property used in the trade or business as defined in section 1231(b), and (2) acquired before January 1, 2006. Gain that is attributable to real property, or to intangible assets, qualifies for the zero-percent rate, provided that such real property or intangible asset is an integral part of a qualified D.C. Zone business.[11] However, no gain attributable to periods before January 1, 1998, and after December 31, 2010, is qualified capital gain.

District of Columbia homebuyer tax credit

First-time homebuyers of a principal residence in the District of Columbia are eligible for a nonrefundable tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000-$130,000 for joint filers). For purposes of eligibility, "first-time homebuyer" means any individual if such individual did not have a present ownership interest in a principal residence in the District of Columbia in the one-year period ending on the date of the purchase of the residence to which the credit applies. The credit is scheduled to expire for residences purchased after December 31, 2005.[12]

REASONS FOR CHANGE

The Committee believes that the D.C. Zone incentives should temporarily be extended to provide the Congress and the Treasury Department a better opportunity to continue to assess the overall operation and effectiveness of the tax incentives to revitalize the D.C. Zone and to promote homeownership therein.

EXPLANATION OF PROVISION

The provision extends the designation of the D.C. Zone (through December 31, 2006), thus extending the wage credit and section 179 expensing.

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[10] Sec. 1400B.

[11] However, sole proprietorships and other taxpayers selling assets directly cannot claim the zero-percent rate on capital gain from the sale of any intangible property (i.e., the integrally related test does not apply).

[12] Sec. 1400C(i).

The provision extends the tax-exempt financing for one year, applying to bonds issued during the period beginning on January 1, 1998, and ending on December 31, 2006.

The provision extends the zero-percent capital gains rate applicable to capital gains from the sale or exchange of certain qualified D.C. Zone assets to gain recognized before January 1, 2011, from the sale of assets acquired before January 1, 2007.

The provision extends the first-time homebuyer credit for one year, through December 31, 2006.

EFFECTIVE DATE

The provision generally is effective on January 1, 2006. The extension of tax-exempt financing is effective for obligations issued after the date of enactment.

J. POSSESSION TAX CREDIT WITH RESPECT TO AMERICAN SAMOA

(sec. 111 of the bill and sec. 936 of the Code)

PRESENT LAW

In general

Certain domestic corporations with business operations in the U.S. possessions are eligible for the possession tax credit.[13] This credit offsets the U.S. tax imposed on certain income related to operations in the U.S. possessions.[14] For purposes of the section 936 credit, possessions include, among other places, American Samoa. Income eligible for the section 936 credit includes non-U.S. source income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investments. The section 936 credit expires for taxable years beginning after December 31, 2005.

To qualify for the possession tax credit for a taxable year, a domestic corporation must satisfy two conditions. First, the corporation must derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation must derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. A domestic corporation that has elected the possession tax credit and that satisfies these two conditions for a taxable year generally is entitled to a credit against the U.S. tax attributable to the taxpayer's income that is eligible for the section 936 credit.

The possession tax credit applies only to a corporation that qualifies as an existing credit claimant. The determination of whether a corporation is an existing credit claimant is made separately for each possession. The possession tax credit is computed separately for each possession with respect to which the corporation is an existing credit claimant, and the credit is subject to either an economic activity-based limitation or an income-based limit.

[13] Secs. 27(b), 936.

[14] Domestic corporations with activities in Puerto Rico are eligible for the section 30A economic activity credit. That credit is calculated under the rules set forth in section 936.

Qualification as existing credit claimant

A corporation is an existing credit claimant with respect to a possession if (1) the corporation was engaged in the active conduct of a trade or business within the possession on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit in an election in effect for its taxable year that included October 13, 1995.[15] A corporation that adds a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceases to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business is added.

Economic activity-based limit

Under the economic activity-based limit, the amount of the credit determined under the rules described above may not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualifying possession wage and fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualifying tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualifying tangible property, plus 65 percent of depreciation allowances with respect to long-life tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes.

Income-based limit

As an alternative to the economic activity-based limit, a taxpayer may elect to apply a limit equal to the applicable percentage of the credit that would otherwise be allowable with respect to possession business income; the applicable percentage currently is 40 percent.

Repeal and phase out

In 1996, the section 936 credit was repealed for new claimants for taxable years beginning after 1995 and was phased out for existing credit claimants over a period including taxable years beginning before 2006. The amount of the available credit during the phaseout period generally is reduced by special limitation rules. These phaseout period limitation rules do not apply to the credit available to existing credit claimants for income from activities in Guam, American Samoa, and the Northern Mariana Islands. The section 936 credit is repealed for all possessions, including Guam, American Samoa, and the Northern Mariana Islands, for all taxable years beginning after 2005.

REASONS FOR CHANGE

The Committee understands that the tuna canning industry is the largest employer in American Samoa[16] and is the primary beneficiary of the section 936 credit in American Samoa. The Committee believes that the expiration of the section 936 credit would negatively impact the economy of American Samoa and that the

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

[16] 2002 Statistical Yearbook of American Samoa, p. xiii; The World Factbook 2005 (Central Intelligence Agency).

credit therefore should be extended for an additional year to provide time for the development of a comprehensive long-term policy with respect to American Samoa.

The Committee is aware that the Government Accountability Office and the staff of the Joint Committee on Taxation are in the process of preparing reports regarding the impact of U.S. Federal tax policy on Puerto Rico, including an analysis of the tax and economic policy implications of proposed legislative options and the revenue costs of those options. The Governor of Puerto Rico has expressed support for the extension of the section 936 credit to American Samoa while awaiting these reports concerning Puerto Rico. Pending completion of these reports, the Committee believes it is appropriate to extend the section 936 credit to American Samoa in recognition of the conditions facing that territory.

EXPLANATION OF PROVISION

The provision extends for one year the present-law section 936 credit as applied to American Samoa; it thus allows existing credit claimants to claim the credit for income from activities in American Samoa in taxable years beginning on or before December 31, 2006.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2005.

K. PARITY IN THE APPLICATION OF CERTAIN LIMITS TO MENTAL HEALTH BENEFITS

(sec. 112 of the bill and sec. 9812 of the Code)

PRESENT LAW

The Code, the Employee Retirement Income Security Act of 1974 ("ERISA") and the Public Health Service Act ("PHSA") contain provisions under which group health plans that provide both medical and surgical benefits and mental health benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits ("mental health parity requirements"). In the case of a group health plan which provides benefits for mental health, the mental health parity requirements do not affect the terms and conditions (including cost sharing, limits on numbers of visits or days of coverage, and requirements relating to medical necessity) relating to the amount, duration, or scope of mental health benefits under the plan, except as specifically provided in regard to parity in the imposition of aggregate lifetime limits and annual limits.

The Code imposes an excise tax on group health plans which fail to meet the mental health parity requirements. The excise tax is equal to $100 per day during the period of noncompliance and is generally imposed on the employer sponsoring the plan if the plan fails to meet the requirements. The maximum tax that can be imposed during a taxable year cannot exceed the lesser of 10 percent of the employer's group health plan expenses for the prior year or $500,000. No tax is imposed if the Secretary determines that the employer did not know, and in exercising reasonable diligence would not have known, that the failure existed.

The mental health parity requirements do not apply to group health plans of small employers nor do they apply if their application results in an increase in the cost under a group health plan of at least one percent. Further, the mental health parity requirements do not require group health plans to provide mental health benefits.

The Code, ERISA and PHSA mental health parity requirements are scheduled to expire with respect to benefits for services furnished after December 31, 2005.

REASONS FOR CHANGE

The Committee recognizes that the Code provisions relating to mental health parity are important to carrying out the purposes of the Mental Health Parity Act. Thus, the Committee believes that extending the Code provisions relating to mental health parity is warranted.

EXPLANATION OF PROVISION

The provision extends for one year the present-law Code excise tax for failure to comply with the mental health parity requirements (through December 31, 2006).

EFFECTIVE DATE

The provision is effective on the date of enactment.

L. RESEARCH CREDIT

(sec. 113 of the bill and sec. 41 of the Code)

PRESENT LAW

General rule

Generally, a taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year. (sec. 41). Thus, the research credit is generally available with respect to incremental increases in qualified research.

The research credit also applies to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the university basic research credit (see sec. 41(e)).

The research credit applies to a taxpayer's expenditures on research undertaken by an energy research consortium. This separate credit computation is commonly referred to as energy research credit. Unlike the general research credit, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit (including the university basic research credit and the energy research credit) is scheduled to expire and generally will not apply to amounts paid or incurred after December 31, 2005.

Computation of allowable credit

Except for energy research payments and certain university basic research payments made by corporations, the research credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of three percent.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenses.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, a special aggregation rule provides that all members of the same controlled group of corporations are treated as a single taxpayer (sec. 41(f)(1)). Under regulations prescribed by the Secretary, special rules apply for computing the credit when a major portion of a trade or business (or unit thereof) changes hands, under which qualified research expenses and gross receipts for periods prior to the change of ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenses and receipts for purposes of recomputing a taxpayer's fixed-base percentage (sec. 41(f)(3)).

Alternative incremental research credit regime

Taxpayers are allowed to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative incremental credit regime, a credit rate of 2.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of one percent (i.e., the base amount equals one percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 3.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of two percent. A credit rate of 3.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of two percent. An election to be subject to this alternative incremental credit regime may be made for any taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years unless revoked with the consent of the Secretary of the Treasury.

Eligible expenses

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

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 (described below) but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which must constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors (sec. 41(d)(3)). In addition, research does not qualify for the credit: (1) if conducted after the beginning of commercial production of the business component; (2) if related to the adaptation of an existing business component to a particular customer's requirements; (3) if related to the duplication of an existing business component from a physical examination of the component itself or certain other information; or (4) if related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control (sec. 41(d)(4)). Research does not qualify for the credit if it is conducted outside the United States, Puerto Rico, or any U.S. possession.

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures paid or incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized. However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research credit determined for the taxable year (Sec. 280C(c)). Taxpayers may alternatively elect to claim a reduced research credit amount under section 41 in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

REASONS FOR CHANGE

The Committee acknowledges that research is important to the economy. Research is the basis of new products, new services, new industries, and new jobs for the domestic economy. Therefore the

Committee believes it is appropriate to extend the present-law research credit. In addition, the Committee is concerned that a number of U.S. companies that engage in research activities are unable to use the current research credit. To encourage these companies to continue and expand their research activities, the Committee believes that the rate of the alternative incremental credit should be increased and that a new alternative simplified credit should be available.

EXPLANATION OF PROVISION

The provision extends for one year and modifies the present-law research credit provision (for amounts paid or incurred through December 31, 2006).

The provision increases the rates of the alternative incremental credit: (1) a credit rate of three percent (rather than 2.65 percent) applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of one percent (i.e., the base amount equals one percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent; (2) a credit rate of four percent (rather than 3.2 percent) applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of two percent; and (3) a credit rate of five percent (rather than 3.75 percent) applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of two percent.

The provision also creates, at the election of the taxpayer, an alternative simplified credit for qualified research expenses. The alternative simplified research is equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to 6 percent if a taxpayer has no qualified research expenses in any one or more of the three preceding taxable years.

An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary. An election to use the alternative simplified credit may not be made for any taxable year for which an election to use the alternative incremental credit is in effect. A special transition rule applies which permits a taxpayer to elect to use the alternative simplified credit in lieu of the alternative incremental credit if such election is made during the taxable year which includes the date of enactment of the provision. The transition rule only applies to the taxable year which includes the date of enactment.

EFFECTIVE DATE

The extension of the research credit applies to amounts paid or incurred after December 31, 2005. The modification of the alternative incremental credit and the creation of the alternative simplified credit are effective for taxable years ending after date of enactment.

M. Qualified Zone Academy Bonds

(sec. 114 of the bill and sec. 1397E of the Code)

PRESENT LAW

Tax-exempt bonds

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

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments are given the authority to issue "qualified zone academy bonds" (sec. 1397E). A total of $400 million of qualified zone academy bonds may be issued annually in calendar years 1998 through 2005. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

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

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

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

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

REASONS FOR CHANGE

The Committee believes that the extension of authority to issue qualified zone academy bonds is appropriate in light of the educational needs that exist today.

EXPLANATION OF PROVISION

The provision extends for one year the present-law provision relating to qualified zone academy bonds (through December 31, 2006).

EFFECTIVE DATE

The provision applies to bonds issued after December 31, 2005.

N. Above-the-Line Deduction for Certain Expenses of Elementary and Secondary School Teachers

(sec. 115 of the bill and sec. 62 of the Code)

PRESENT LAW

In general, ordinary and necessary business expenses are deductible (sec. 162). However, in general, unreimbursed employee business expenses are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. An individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of $145,950 (for 2005). In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Certain expenses of eligible educators are allowed an above-the-line deduction. Specifically, for taxable years beginning prior to January 1, 2006, an above-the-line deduction is allowed for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom. To be eligible for this deduction, the expenses must be otherwise deductible under section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under section 135 (relating to education savings bonds), section 529(c)(1) (relating to qualified tuition programs), and section 530(d)(2) (relating to Coverdell education savings accounts).

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

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2005.

REASONS FOR CHANGE

The Committee recognizes that elementary and secondary educators often incur substantial unreimbursed expenses in the course of their teaching duties, and believes that an extension of the deduction of such expenses is warranted to continue to provide tax relief to educators who incur such expenses on behalf of their students.

EXPLANATION OF PROVISION

The provision extends for one year the present-law deduction for expenses of eligible educators (through taxable years beginning on or before December 31, 2006).

EFFECTIVE DATE

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2005.

O. ABOVE-THE-LINE DEDUCTION FOR HIGHER EDUCATION EXPENSES

(sec. 116 of the bill and sec. 222 of the Code)

PRESENT LAW

An individual is allowed an above-the-line deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year. Qualified tuition and related expenses include tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the deduction. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual, and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain United States Savings Bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings account. Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion under section 529 is claimed with respect to expenses eligible for exclusion under section 222. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope credit or Lifetime Learning credit is elected for such taxable year.

The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic term beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

For taxable years beginning in 2004 and 2005, the maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2005.

REASONS FOR CHANGE

The Committee recognizes that in some cases a deduction for education expenses may provide greater tax relief than the present-law education tax credits. In order to provide families with a range of options for education, the Committee believes that extending the deduction for higher education expenses is warranted.

EXPLANATION OF PROVISION

The provision extends the present-law tuition deduction for one year (through taxable years beginning on or before December 31, 2006).

EFFECTIVE DATE

The provision is effective for payments made in taxable years beginning after December 31, 2005.

P. DEDUCTION OF STATE AND LOCAL GENERAL SALES TAXES

(sec. 117 of the bill and sec. 164 of the Code)

PRESENT LAW

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning in 2004 and 2005, at the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes. As is the case for State and local income taxes, the itemized deduction for State and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary of the Treasury that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account filing status, number of dependents, adjusted gross income and rates of State and local general sales taxation. Taxpayers who use the tables created by the Secretary may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

The term "general sales tax" means a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items. However, in the case of items of food, clothing, medical supplies, and motor vehicles, the fact that the tax does not apply with respect to some or all of such items is not taken into account in determining whether the tax applies with respect to a broad range of classes of items, and the fact that the rate of tax applicable with respect to some or all of such items is lower than the general rate of tax is not taken into account in determining whether the tax is imposed at one rate. Except in the case of a lower rate of tax applicable with respect to food, clothing, medical supplies, or motor vehicles, no deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess shall be disregarded and the general rate is treated as the rate of tax.

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

REASONS FOR CHANGE

The Committee recognizes that not all States rely on income taxes as a primary source of revenue, and that allowing a deduction for State and local income taxes, but not sales taxes, may create inequities across States and may also create bias in the types of taxes that States and localities choose to impose. The Committee believes that the provision of an itemized deduction for State and local general sales taxes in lieu of the deduction for State and local income taxes provides more equitable Federal tax treatment across States, and will cause the Federal tax laws to have a more neutral effect on the types of taxes that State and local governments utilize. For these reasons, the Committee believes the extension of this provision is warranted.

EXPLANATION OF PROVISION

The provision extends for one year the present-law provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes (through taxable years beginning on or before December 31, 2006).

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2005.

TITLE II—EXTENSIONS OF CERTAIN PROVISIONS FOR TWO YEARS, AND OTHER MODIFICATIONS

A. EXTENSION AND EXPANSION TO PETROLEUM PRODUCTS OF EXPENSING FOR ENVIRONMENTAL REMEDIATION COSTS

(sec. 201 of the bill and sec. 198 of the Code)

PRESENT LAW

Present law allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[17] Treasury regulations provide that the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury regulations define "capital expenditures" as amounts paid or incurred to materially add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use. Amounts paid for repairs and maintenance do not constitute capital expenditures. The determination of whether an expense is deductible or capitalizable is based on the facts and circumstances of each case.

Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred.[18] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which would otherwise be allocated to the site under the principles set forth in *Commissioner* v. *Idaho Power Co.*[19] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" (a so-called "brownfield") generally is any property that is held for use in a trade or business, for the production of income, or as inventory and is certified by the appropriate State environmental agency to be an area at or on which there has been a release (or threat of release) or disposal of a hazardous substance. Both urban and rural property may qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA") cannot qualify as targeted areas. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to

[17] Sec. 162.
[18] Sec. 198.
[19] 418 U.S. 1 (1974).

deterioration through ordinary use. Petroleum products generally are not regarded as hazardous substances for purposes of section 198.[20]

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures are subject to recapture as ordinary income upon a sale or other disposition of the property. In addition, sections 280B (demolition of structures) and 468 (special rules for mining and solid waste reclamation and closing costs) do not apply to amounts that are treated as expenses under this provision.

Eligible expenditures are those paid or incurred before January 1, 2006.

REASONS FOR CHANGE

The Committee observes that by lowering the net capital cost of a development project, the expensing of brownfields remediation costs promotes the goal of environmental remediation and promotes new investment and employment opportunities. In addition, the Committee believes that the increased investment in the qualifying areas has spillover effects that are beneficial to the neighboring communities. Finally, the Committee recognizes that similar principles apply with respect to contamination by petroleum products. Therefore, the Committee believes it is appropriate to extend the present-law provision permitting the expensing of environmental remediation costs, and to expand the scope of the present-law provision to include petroleum products.

EXPLANATION OF PROVISION

The provision extends for two years the present-law provisions relating to environmental remediation expenditures (through December 31, 2007).

In addition, the provision expands the definition of hazardous substance to include petroleum products. Under the proposal, petroleum products are defined by reference to section 4612(a)(3), and thus include crude oil, crude oil condensates and natural gasoline.[21]

EFFECTIVE DATE

The provision applies to expenditures paid or incurred after December 31, 2005.

[20] Section 101(14) of CERCLA specifically excludes "petroleum, including crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under subparagraphs (A) through (F) of this paragraph," from the definition of "hazardous substance."

[21] The present law exceptions for sites on the national priorities list under CERCLA, and for substances with respect to which a removal or remediation is not permitted under section 104 of CERCLA by reason of subsection (a)(3) thereof, would continue to apply to all hazardous substances (including petroleum products).

B. Controlled Foreign Corporations

1. Subpart F exception for active financing (sec. 202(a) of the bill and secs. 953 and 954 of the Code)

PRESENT LAW

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

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and REMICs; (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income.[22]

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business (so-called "active financing income").[23]

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

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

[23] Temporary exceptions from the subpart F provisions for certain active financing income applied only for taxable years beginning in 1998. Those exceptions were modified and extended for one year, applicable only for taxable years beginning in 1999. The Tax Relief Extension Act of 1999 (Pub. L. No. 106–170) clarified and extended the temporary exceptions for two years, applicable only for taxable years beginning after 1999 and before 2002. The Job Creation and Worker Assistance Act of 2002 (Pub. L. No. 107–147) modified and extended the temporary exceptions for five years, for taxable years beginning after 2001 and before 2007.

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

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

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

Present law permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes. In seeking a ruling, the taxpayer is required to provide the IRS with necessary and appropriate information as to the method, interest rate, mortality and morbidity assumptions and other assumptions under the foreign reserve rules so that a comparison can be made to the reserve amount determined by applying the tax reserve method that would apply if the qualifying insurance company were subject to tax under Subchapter L of the Code (with the modifications provided under present law for purposes of these exceptions). The IRS also may issue published guidance indicating its approval. Present law continues to apply with respect to reserves for any life insurance or annuity contract for which the IRS has not approved the use of the foreign statement reserve. An IRS ruling request under this provision is subject to the present-law provisions relating to IRS user fees.

REASONS FOR CHANGE

In the Taxpayer Relief Act of 1997, one-year temporary exceptions from foreign personal holding company income were enacted for income from the active conduct of an insurance, banking, financing, or similar business.[24] In 1998, 1999, and 2002, the provisions were extended, and in some cases, modified.[25] The Committee believes that it is appropriate to extend the temporary provisions, as modified by the previous legislation, for an additional two years.

EXPLANATION OF PROVISION

The provision extends for two years (for taxable years beginning before 2009) the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

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[24] The President canceled this provision in 1997 pursuant to the Line Item Veto Act. On June 25, 1998, the Supreme Court held that the cancellation procedures set forth in the Line Item Veto Act are unconstitutional. *Clinton* v. *City of New York*, 524 U.S. 417 (1998).

[25] The Tax and Trade Relief Extension Act of 1998, Division J, Making Omnibus Consolidated and Emergency Supplemental Appropriations for Fiscal Year 1999, Pub. L. No. 105–277, sec. 1005 (1998), provided a one-year extension, with modifications. The Tax Relief Extension Act of 1999, Pub.L. No. 106–170, sec. 503 (1999), provided an additional two-year extension, with a clarification. The Job Creation and Worker Assistance Act of 2002 (Pub. L. No. 107–147, sec. 614) provided an additional five-year extension and provided that in certain circumstances an insurance company may establish reserves taking into account foreign statement reserves. The House bill, H.R. 3090, the "Economic Security and Recovery Act of 2001," had provided for a permanent extension (H. R. Rep. No. 107–251 at 50 (2001)), while the Senate bill, the "Economic Recovery and Assistance for American Workers Act of 2001," had provided for a one-year extension. See S. Prt. No. 107–49 at 58–60 (2001).

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2006, and before January 1, 2009, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

2. Look-through treatment of payments between related controlled foreign corporations under foreign personal holding company income rules (sec. 202(b) of the bill and sec. 954(c) of the Code)

PRESENT LAW

In general, the rules of subpart F (secs. 951–964) require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation ("CFC") to include certain income of the CFC (referred to as "subpart F income") on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal holding company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. However, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor.

REASONS FOR CHANGE

Most countries allow their companies to redeploy active foreign earnings with no additional tax burden. The Committee believes that this provision will make U.S. companies and U.S. workers more competitive with respect to such countries. By allowing U.S. companies to reinvest their active foreign earnings where they are most needed without incurring the immediate additional tax that companies based in many other countries never incur, the Committee believes that the provision will enable U.S. companies to make more sales overseas, and thus produce more goods in the United States.

EXPLANATION OF PROVISION

Under the provision, for taxable years beginning after 2005 and before 2009, dividends, interest,[26] rents, and royalties received by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to non-subpart-F income of the payor. For this purpose, a related CFC is a CFC that controls or is controlled by the other CFC, or a CFC that is controlled by the same person or persons that control the other CFC. Ownership of more than 50 percent of the

[26] Interest for this purpose includes factoring income which is treated as equivalent to interest under sec. 954(c)(1)(E).

CFC's stock (by vote or value) constitutes control for these purposes.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2005 but before January 1, 2009, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

C. Reduced Rates for Capital Gains and Dividends of Individuals

(sec. 203 of the bill and sec. 1(h) of the Code)

PRESENT LAW

Capital gains

In general

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to $3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances that would have been available under the straight-line method of depreciation.

Tax rates before 2009

Under present law, for taxable years beginning before January 1, 2009, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. Any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a five-percent rate (zero for taxable years beginning after 2007).

These rates apply for purposes of both the regular tax and the alternative minimum tax.

Under present law, the "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof), an amount of gain equal to the amount of gain excluded from gross income under section 1202 (relating to certain small business stock), the net short-term capital loss for the taxable year, and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

An individual's unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

Tax rates after 2008

For taxable years beginning after December 31, 2008, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. Any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a 10-percent rate.

In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10-percent rate is taxed at an eight-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which began after December 31, 2000, that would otherwise have been taxed at a 20-percent rate is taxed at an 18-percent rate.

The tax rates on 28-percent gain and unrecaptured section 1250 gain are the same as for taxable years beginning before 2009.

Dividends

In general

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits.

Tax rates before 2009

Under present law, dividends received by an individual from domestic corporations and qualified foreign corporations are taxed at the same rates that apply to capital gains. This treatment applies for purposes of both the regular tax and the alternative minimum tax. Thus, for taxable years beginning before 2009, dividends received by an individual are taxed at rates of five (zero for taxable years beginning after 2007) and 15 percent.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Qualified dividend income includes otherwise qualified dividends received from qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation with respect to any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

Special rules apply in determining a taxpayer's foreign tax credit limitation under section 904 in the case of qualified dividend income. For these purposes, rules similar to the rules of section 904(b)(2)(B) concerning adjustments to the foreign tax credit limitation to reflect any capital gain rate differential will apply to any qualified dividend income.

If a taxpayer receives an extraordinary dividend (within the meaning of section 1059(c)) eligible for the reduced rates with respect to any share of stock, any loss on the sale of the stock is treated as a long-term capital loss to the extent of the dividend.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the company is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (i) the qualified dividend income of the RIC for the taxable year and (ii) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of dividends qualifying for reduced rates that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (i) the qualified dividend income of the REIT for the taxable year, (ii) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (iii) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

The reduced rates do not apply to dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities.[27]

Tax rates after 2008

For taxable years beginning after 2008, dividends received by an individual are taxed as ordinary income at rates of up to 35 percent.

REASONS FOR CHANGE

The Committee believes that the lower capital gain and dividend rates have had a positive effect on the economy and should be extended to continue to promote economic growth by increasing the after-tax return to saving and investment. The Committee further believes that the extension will encourage the payment of dividends by corporations.

EXPLANATION OF PROVISION

The bill extends for two years the present-law provisions relating to lower capital gain and dividend tax rates (through taxable years beginning on or before December 31, 2010).

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2008.

D. Credit for Elective Deferrals and IRA Contributions (the "Saver's Credit")

(sec. 204 of the bill and sec. 25B of the Code)

PRESENT LAW

Present law provides a temporary nonrefundable tax credit for eligible taxpayers for qualified retirement savings contributions, referred to as the "saver's credit." The maximum annual contribution eligible for the credit is $2,000. The credit rate depends on the adjusted gross income ("AGI") of the taxpayer. Taxpayers filing joint returns with AGI of $50,000 or less, head of household returns of $37,500 or less, and single returns of $25,000 or less are eligible for the credit. The AGI limits applicable to single taxpayers apply to married taxpayers filing separate returns. The credit is in addi-

[27] In addition, for taxable years beginning before 2009, amounts treated as ordinary income on the disposition of certain preferred stock (sec. 306) are treated as dividends for purposes of applying the reduced rates; the tax rate for the accumulated earnings tax (sec. 531) and the personal holding company tax (sec. 541) is reduced to 15 percent; and the collapsible corporation rules (sec. 341) are repealed.

tion to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability. The credit is available to individuals who are 18 or over, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

The credit is available with respect to: (1) elective deferrals to a qualified cash or deferred arrangement (a "section 401(k) plan"), a tax-sheltered annuity (a "section 403(b)" annuity), an eligible deferred compensation arrangement of a State or local government (a "governmental section 457 plan"), a SIMPLE plan, or a simplified employee pension ("SEP"); (2) contributions to a traditional or Roth IRA; and (3) voluntary after-tax employee contributions to a tax-sheltered annuity or qualified retirement plan.

The amount of any contribution eligible for the credit is generally reduced by distributions received by the taxpayer (or by the taxpayer's spouse if the taxpayer filed a joint return with the spouse) from any plan or IRA to which eligible contributions can be made during the taxable year for which the credit is claimed, the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date for filing the taxpayer's return for the year. Distributions that are rolled over to another retirement plan do not affect the credit.

The credit rates based on AGI are provided in the table below.

TABLE 1.—CREDIT RATES FOR SAVER'S CREDIT

Joint filers	Heads of households	All other filers	Credit rate (percent)
$0–$30,000	$0–$22,500	$0–$15,000	50
30,001–32,500	22,501–24,375	15,001–16,250	20
32,501–50,000	24,376–37,500	16,251–25,000	10
Over 50,000	Over 37,500	Over 25,000	0

The credit does not apply to taxable years beginning after December 31, 2006.[28]

REASONS FOR CHANGE

Many low- and middle-income individuals have inadequate savings for retirement. The Committee believes that the saver's credit provides an incentive for low- and middle-income individuals to save for retirement. The Committee believes that the credit should be extended to provide a more consistent savings incentive.

EXPLANATION OF PROVISION

The provision extends the saver's credit for two years (through taxable years beginning on or before December 31, 2008).

EFFECTIVE DATE

The provision is effective on the date of enactment.

[28] The saver's credit was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), Pub. L. No. 107–16. The provisions of EGTRRA generally do not apply for years beginning after December 31, 2010.

E. Extension of Increased Expensing for Small Business

(sec. 205 of the bill and sec. 179 of the Code)

PRESENT LAW

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2003 through 2007, is $100,000 of the cost of qualifying property placed in service for the taxable year.[29] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2008 is treated as qualifying property. The $100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $400,000. The $100,000 and $400,000 amounts are indexed for inflation for taxable years beginning after 2003 and before 2008.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[30]

For taxable years beginning in 2008 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner.[31]

REASONS FOR CHANGE

The Committee believes that section 179 expensing provides two important benefits for small businesses. First, it lowers the cost of capital for property used in a trade or business. With a lower cost of capital, the Committee believes small businesses will invest in more equipment and employ more workers. Second, it eliminates

[29] Additional section 179 incentives are provided with respect to a qualified property used by a business in the New York Liberty Zone (sec. 1400L(f)), an empowerment zone (sec. 1397A), or a renewal community (sec. 1400J).

[30] Sec. 179(c)(1). Under Treas. Reg. sec. 179–5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

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

depreciation recordkeeping requirements with respect to expensed property. In 2004, Congress acted to increase the value of these benefits and to increase the number of taxpayers eligible for taxable years through 2007. The Committee believes that the changes to section 179 expensing will continue to provide important benefits if extended, and the bill therefore extends these changes for an additional two years.

EXPLANATION OF PROVISION

The provision extends for two years the increased amount that a taxpayer may deduct and the other section 179 rules applicable in taxable years beginning before 2008. Thus, under the provision, these present-law rules continue in effect for taxable years beginning after 2007 and before 2010.

EFFECTIVE DATE

The provision is effective for taxable years beginning after 2007 and before 2010.

TITLE III—OTHER PROVISIONS

A. TAXATION OF CERTAIN SETTLEMENT FUNDS

(sec. 301 of the bill and sec. 468B of the Code)

PRESENT LAW

Present law provides that if a taxpayer makes a payment to a designated settlement fund pursuant to a court order, the deduction timing rules that require economic performance generally are deemed to be met as the payments are made by the taxpayer to the fund. A designated settlement fund means a fund which: is established pursuant to a court order; extinguishes completely the taxpayer's tort liability arising out of personal injury, death or property damage; is administered by persons a majority of whom are independent of the taxpayer; and under the terms of the fund the taxpayer (or any related person) may not hold any beneficial interest in the income or corpus of the fund.

Generally, a designated or qualified settlement fund is taxed as a separate entity at the maximum trust rate on its modified income. Modified income is generally gross income less deductions for administrative costs and other incidental expenses incurred in connection with the operation of the settlement fund.

The cleanup of hazardous waste sites is sometimes funded by environmental "settlement funds" or escrow accounts. These escrow accounts are established in consent decrees between the Environmental Protection Agency ("EPA") and the settling parties under the jurisdiction of a Federal district court. The EPA uses these accounts to resolve claims against private parties under Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA").

Present law provides that nothing in any provision of law is to be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax.

REASONS FOR CHANGE

The Committee believes that environmental escrow accounts established under court consent decrees are essential for the EPA to resolve or satisfy claims under the CERCLA. The tax treatment of these settlement funds may prevent taxpayers from entering into prompt settlements with the EPA for the cleanup of Superfund hazardous waste sites and reduce the ultimate amount of funds available for the sites' cleanup. Because these settlement funds are controlled by the government and, upon termination, any remaining funds belong to the government, the Committee believes it is appropriate to establish that these funds are to be treated as beneficially owned by the United States.

EXPLANATION OF PROVISION

The provision provides that certain settlement funds established in consent decrees for the sole purpose of resolving claims under CERCLA are to be treated as beneficially owned by the United States government and therefore, not subject to Federal income tax.

To qualify the settlement fund must be: (1) established pursuant to a consent decree entered by a judge of a United States District Court; (2) created for the receipt of settlement payments for the sole purpose of resolving claims under CERCLA; (3) controlled (in terms of expenditures of contributions and earnings thereon) by the government or an agency or instrumentality thereof; and (4) upon termination, any remaining funds will be disbursed to such government entity and used in accordance with applicable law. For purposes of the provision, a government entity means the United States, any State of political subdivision thereof, the District of Columbia, any possession of the United States, and any agency or instrumentality of the foregoing.

The provision does not apply to accounts or funds established after December 31, 2010.

EFFECTIVE DATE

The provision is effective for accounts and funds established after the date of enactment.

B. MODIFICATION OF ACTIVE BUSINESS DEFINITION UNDER SECTION 355

(sec. 302 of the bill and sec. 355 of the Code)

PRESENT LAW

A corporation generally is required to recognize gain on the distribution of property (including stock of a subsidiary) to its shareholders as if such property had been sold for its fair market value. An exception to this rule applies if the distribution of the stock of a controlled corporation satisfies the requirements of section 355 of the Code. To qualify for tax-free treatment under section 355, both the distributing corporation and the controlled corporation must be engaged immediately after the distribution in the active conduct of a trade or business that has been conducted for at least five years and was not acquired in a taxable transaction during that period.[32] For this purpose, a corporation is engaged in the active conduct of a trade or business only if (1) the corporation is directly engaged in the active conduct of a trade or business, or (2) the corporation is not directly engaged in an active business, but substantially all of its assets consist of stock and securities of a corporation it controls that is engaged in the active conduct of a trade or business.[33]

In determining whether a corporation is directly engaged in an active trade or business that satisfies the requirement, old IRS guidelines for advance ruling purposes required that the value of the gross assets of the trade or business being relied on must ordinarily constitute at least five percent of the total fair market value of the gross assets of the corporation directly conducting the trade or business.[34] More recently, the IRS has suspended this specific rule in connection with its general administrative practice of moving IRS resources away from advance rulings on factual aspects of section 355 transactions in general.[35]

If the distributing or controlled corporation is not directly engaged in an active trade or business, then the IRS takes the position that the "substantially all" test requires that at least 90 percent of the fair market value of the corporation's gross assets consist of stock and securities of a controlled corporation that is engaged in the active conduct of a trade or business.[36]

REASONS FOR CHANGE

Prior to a spin-off under section 355 of the Code, corporate groups that have conducted business in separate corporate entities often must undergo elaborate restructurings to place active businesses in the proper entities to satisfy the five-year active business requirement. If the top-tier corporation of a chain that is being spun off or retained is a holding company, then the requirements regarding the activities of its subsidiaries are more stringent than if the top-tier corporation itself engaged in some active business. The Committee believes that it is appropriate to simplify planning for corporate groups that use a holding company structure to engage in distributions that qualify for tax-free treatment under section 355.

EXPLANATION OF PROVISION

Under the bill, the active business test is determined by reference to the relevant affiliated group. For the distributing corporation, the relevant affiliated group consists of the distributing corporation as the common parent and all corporations affiliated with the distributing corporation through stock ownership described in section 1504(a)(1)(B) (regardless of whether the corporations are includible corporations under section 1504(b)), immediately after the distribution. The relevant affiliated group for a controlled corporation is determined in a similar manner (with the controlled corporation as the common parent).

[32] Section 355(b).
[33] Section 355(b)(2)(A).
[34] Rev. Proc. 2003–3, sec. 4.01(30), 2003–1 I.R.B. 113.
[35] Rev. Proc. 2003–48, 2003–29 I.R.B. 86.
[36] Rev. Proc. 96–30, sec. 4.03(5), 1996–1 C.B. 696; Rev. Proc. 77–37, sec. 3.04, 1977–2 C.B. 568.

EFFECTIVE DATE

The bill applies to distributions after the date of enactment and before December 31, 2010, with three exceptions. The bill does not apply to distributions (1) made pursuant to an agreement which is binding on the date of enactment and at all times thereafter, (2) described in a ruling request submitted to the IRS on or before the date of enactment, or (3) described on or before the date of enactment in a public announcement or in a filing with the Securities and Exchange Commission. The distributing corporation may irrevocably elect not to have the exceptions described above apply.

In the case of any distribution prior to the date of enactment, solely for the purpose of determining whether, after the date of enactment, the taxpayer continues to satisfy the requirements of section 355(b)(2)(A) as a result of an acquisition, disposition, or other restructuring after such date and before December 31, 2010, the provisions of the bill apply as if the distribution had occurred after the date of enactment.[37]

C. QUALIFIED VETERAN'S MORTGAGE BONDS

(sec. 303 of the bill and sec. 143 of the Code)

PRESENT LAW

Qualified veterans' mortgage bonds are private activity bonds the proceeds of which are used to make mortgage loans to certain veterans. Authority to issue qualified veterans' mortgage bonds is limited to States that had issued such bonds before June 22, 1984. Qualified veterans' mortgage bonds are not subject to the State volume limitations generally applicable to private activity bonds. Instead, annual issuance in each State is subject to a State volume limitation based on the volume of such bonds issued by the State before June 22, 1984. The five States eligible to issue these bonds are Alaska, California, Oregon, Texas, and Wisconsin. Loans financed with qualified veterans' mortgage bonds can be made only with respect to principal residences and can not be made to acquire or replace existing mortgages. Mortgage loans made with the proceeds of these bonds can be made only to veterans who served on active duty before 1977 and who applied for the financing before the date 30 years after the last date on which such veteran left active service (the "eligibility period").

REASONS FOR CHANGE

The Committee believes that the qualified veterans' mortgage bond program should be expanded to more recent veterans including potentially the men and women serving on active duty today. The Committee also believes that such an expansion requires modified volume limits for these bonds.

[37] For example, a holding company taxpayer that had distributed a controlled corporation in a spin-off prior to the date of enactment, in which spin-off the taxpayer satisfied the "substantially all" active business stock test of present law section 355(b)(2)(A) immediately after the distribution, would not be deemed to have failed to satisfy any requirement that it continue that same qualified structure for any period of time after the distribution, solely because of a restructuring that occurs after the date of enactment and that would satisfy the requirements of new section 355(b)(2)(A).

EXPLANATION OF PROVISION

The bill repeals the requirement that veterans receiving loans financed with veterans' bonds must have served before 1977. It also reduces the eligibility period to 25 years (rather than 30 years) following release from the military service. The bill provides new State volume limits for these bonds for the five eligible States. In 2010, the new annual limit on the total volume of veterans' bonds is $25 million for Alaska, $66.25 million for California, $25 million for Oregon, $53.75 million for Texas, and $25 million for Wisconsin. These volume limits are phased-in over the four-year period immediately preceding 2010 by allowing the applicable percentage of the 2010 volume limits. The following table provides those percentages.

Calendar year:	*Applicable percentage is:*
2006	20 percent
2007	40 percent
2008	60 percent
2009	80 percent

The volume limits are zero for 2011 and each year thereafter. Unused allocation cannot be carried forward to subsequent years.

EFFECTIVE DATE

The provision generally applies to bonds issued after December 31, 2005. The provision expanding the definition of eligible veterans applies to financing provided after June 30, 2005.

D. CAPITAL GAINS TREATMENT FOR CERTAIN SELF-CREATED MUSICAL WORKS

(sec. 304 of the bill and sec. 1221 of the Code)

PRESENT LAW

Capital gains

The maximum tax rate on the net capital gain income of an individual is 15 percent for taxable years beginning in 2005. By contrast, the maximum tax rate on an individual's ordinary income is 35 percent. The reduced 15-percent rate generally is available for gain from the sale or exchange of a capital asset for which the taxpayer has satisfied a holding-period requirement. Capital assets generally include all property held by a taxpayer with certain specified exclusions.

An exclusion from the definition of a capital asset applies to inventory property or property held by a taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. Another exclusion from capital asset status applies to copyrights, literary, musical, or artistic compositions, letters or memoranda, or similar property held by a taxpayer whose personal efforts created the property (or held by a taxpayer whose basis in the property is determined by reference to the basis of the taxpayer whose personal efforts created the property). Consequently, when a taxpayer that owns copyrights in, for example, books, songs, or paintings that the taxpayer created (or when a taxpayer to which the copyrights have been transferred by the works' creator in a substituted basis transaction) sells the copyrights, gain from the sale is treated as ordinary income, not capital gain.

Charitable contributions

A taxpayer generally is allowed a deduction for the fair market value of property contributed to a charity. If a taxpayer makes a contribution of property that would have generated ordinary income (or short-term capital gain), the taxpayer's charitable contribution deduction generally is limited to the property's adjusted basis.

REASONS FOR CHANGE

The Committee believes it is appropriate to allow taxpayers to treat as capital gain the income from a sale or exchange of musical compositions or copyrights in musical works the taxpayer created.

EXPLANATION OF PROVISION

The provision provides that at the election of a taxpayer, the sale or exchange before January 1, 2011 of musical compositions or copyrights in musical works created by the taxpayer's personal efforts (or having a basis determined by reference to the basis in the hands of the taxpayer whose personal efforts created the compositions or copyrights) is treated as the sale or exchange of a capital asset. The provision does not change the present law limitation on a taxpayer's charitable deduction for the contribution of such compositions or copyrights.

EFFECTIVE DATE

The provision is effective for sales or exchanges in taxable years beginning after the date of enactment.

E. Decrease Minimum Vessel Tonnage Limit to 6,000 Deadweight Tons

(sec. 305 of the bill and sec. 1355 of the Code)

PRESENT LAW

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, including income from shipping operations, whether derived in the United States or abroad. In order to mitigate double taxation, a foreign tax credit for income taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Generally, the United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income, including income from shipping operations, which is "effectively connected" with the conduct of a trade or business in the United States (sec. 882). Such "effectively connected income" generally is taxed in the same manner and at the same rates as the income of a U.S. corporation.

The United States imposes a four percent tax on the amount of a foreign corporation's U.S. source gross transportation income (sec. 887). Transportation income includes income from the use (or hiring or leasing for use) of a vessel and income from services directly related to the use of a vessel. Fifty percent of the transportation income attributable to transportation that either begins or ends (but not both) in the United States is treated as U.S. source gross transportation income. The tax does not apply, however, to U.S. source gross transportation income that is treated as income effectively connected with the conduct of a U.S. trade or business. U.S. source gross transportation income is not treated as effectively connected income unless (1) the taxpayer has a fixed place of business in the United States involved in earning the income, and (2) substantially all the income is attributable to regularly scheduled transportation.

The tax imposed by section 882 or 887 on income from shipping operations may be limited by an applicable U.S. income tax treaty or by an exemption of a foreign corporation's international shipping operations income in instances where a foreign country grants an equivalent exemption (sec. 883).

Notwithstanding the general rules described above, the American Jobs Creation Act of 2004 ("AJCA")[38] generally allows corporations that are qualifying vessel operators[39] to elect a "tonnage tax" in lieu of the corporate income tax on taxable income from certain shipping activities. Accordingly, an electing corporation's gross income does not include its income from qualifying shipping activities (and items of loss, deduction, or credit are disallowed with respect to such excluded income), and electing corporations are only subject to tax on these activities at the maximum corporate income tax rate on their notional shipping income, which is based on the net tonnage of the corporation's qualifying vessels.[40] No deductions are allowed against the notional shipping income of an electing corporation, and no credit is allowed against the notional tax imposed under the tonnage tax regime. In addition, special deferral rules apply to the gain on the sale of a qualifying vessel, if such vessel is replaced during a limited replacement period.

Generally, a "qualifying vessel" is defined as a self-propelled (or a combination of self-propelled and non-self-propelled) U.S.-flag vessel of not less than 10,000 deadweight tons[41] that is used exclusively in the U.S. foreign trade.

REASONS FOR CHANGE

The Committee believes that the tonnage tax regime provides operators of qualifying U.S.-flag vessels in the U.S. foreign trade the opportunity to be competitive with their tax-advantaged foreign

[38] Pub. L. No. 108–357, sec. 248. The tonnage tax regime is effective for taxable years beginning after the date of enactment of AJCA (October 22, 2004).

[39] Generally, a qualifying vessel operator is a corporation that (1) operates one or more qualifying vessels and (2) meets certain requirements with respect to its shipping activities.

[40] An electing corporation's notional shipping income for the taxable year is the product of the following amounts for each of the qualifying vessels it operates: (1) the daily notional shipping income from the operation of the qualifying vessel, and (2) the number of days during the taxable year that the electing corporation operated such vessel as a qualifying vessel in the United States foreign trade. The daily notional shipping income from the operation of a qualifying vessel is (1) 40 cents for each 100 tons of so much of the net tonnage of the vessel as does not exceed 25,000 net tons, and (2) 20 cents for each 100 tons of so much of the net tonnage of the vessel as exceeds 25,000 net tons. "United States foreign trade" means the transportation of goods or passengers between a place in the United States and a foreign place or between foreign places. The temporary use in the United States domestic trade (i.e., the transportation of goods or passengers between places in the United States) of any qualifying vessel or the temporary ceasing to use a qualifying vessel may be disregarded, under special rules.

[41] Deadweight measures the lifting capacity of a ship expressed in long tons (2,240 lbs.), including cargo, crew, and consumables such as fuel, lube oil, drinking water, and stores. It is the difference between the number of tons of water a vessel displaces without such items on board and the number of tons it displaces when fully loaded.

competitors. However, there are a number of U.S.-flag vessels that are operated in the U.S. foreign trade but which do not qualify for tonnage tax treatment because their carrying capacity is less than 10,000 deadweight tons. The Committee believes that the expansion of the tonnage tax regime to smaller vessels will permit the operators of such vessels to be competitive with their foreign competitors as well as with their larger U.S.-flag competitors.

EXPLANATION OF PROVISION

The provision expands the definition of "qualifying vessel" to include self-propelled (or a combination of self-propelled and non-self-propelled) U.S. flag vessels of not less than 6,000 deadweight tons used exclusively in the United States foreign trade. The modified definition applies for taxable years beginning after December 31, 2005 and ending before January 1, 2011.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2005 and ending before January 1, 2011.

F. MODIFICATION OF SPECIAL ARBITRAGE RULE FOR CERTAIN FUNDS

(sec. 306 of the bill)

PRESENT LAW

In general, present-law tax-exempt bond arbitrage restrictions provide that interest on a State or local government bond is not eligible for tax-exemption if the proceeds are invested, directly or indirectly, in materially higher yielding investments or if the debt service on the bond is secured by or paid from (directly or indirectly) such investments. An exception to the arbitrage restrictions, enacted in 1984, provides that the pledge of income from investments in the Texas Permanent University Fund (the "Fund") as security for a limited amount of tax-exempt bonds will not cause interest on those bonds to be taxable. The terms of this exception are limited to State constitutional or statutory restrictions continuously in effect since October 9, 1969. In addition, the exception only applies to an amount of tax-exempt bonds that does not exceed 20 percent of the value of the Fund.

The Fund consists of certain State lands that were set aside for the benefit of higher education, the income from mineral rights to these lands, and certain other earnings on Fund assets. The Texas constitution directs that monies held in the Fund are to be invested in interest-bearing obligations and other securities. Income from the Fund is apportioned between two university systems operated by the State. Tax-exempt bonds issued by the university systems to finance buildings and other permanent improvements were secured by and payable from the income of the Fund.

Prior to 1999, the constitution did not permit the expenditure or mortgage of the Fund for any purpose. In 1999, the State constitutional rules governing the Fund were modified with regard to the manner in which amounts in the Fund are distributed for the benefit of the two university systems. The State constitutional amendments allow for the possibility that in the event investment earnings are less than annual debt service on the bonds some of the debt service could be considered as having been paid with the Fund corpus. The 1984 exception refers only to bonds secured by investment earnings on securities or obligations held by the Fund. Despite the constitutional amendments, the IRS has agreed to continue to apply the 1984 exception to the Fund through August 31, 2007, if clarifying legislation is introduced in the 109th Congress prior to August 31, 2005. Clarifying legislation was introduced in the 109th Congress on May 26, 2005.[42]

REASONS FOR CHANGE

The Committee understands that the State constitutional amendments have the effect of permitting the Fund to make annual distributions in a manner similar to standard university endowment funds, rather than tying distributions to annual income performance, which can create a variable pattern of distributions. The Committee does not believe that the Fund should lose the benefits of the 1984 exception from the tax-exempt bond arbitrage restrictions by adopting a more modern approach to the management of Fund distributions.

EXPLANATION OF PROVISION

The provision affirms and extends the IRS agreement through August 31, 2009. The 1984 exception is conformed to the State constitutional amendments to permit its continued applicability to bonds of the two university systems. The limitation on the aggregate amount of bonds which may benefit from the exception is not modified, and remains at 20 percent. The provision sunsets after August 31, 2009.

EFFECTIVE DATE

The provision is effective on the date of enactment.

IV. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statements are made concerning the vote of the Committee on Ways and Means in its consideration of H.R. 4297, to provide for reconciliation pursuant to section 201(b) of the concurrent resolution on the budget for fiscal year 2006.

MOTION TO REPORT RECOMMENDATIONS

The Chairman's Amendment in the Nature of a Substitute, as amended, was ordered favorably reported by a rollcall vote of 24 yeas to 15 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas	X			Mr. Rangel		X	
Mr. Shaw	X			Mr. Stark			
Mrs. Johnson	X			Mr. Levin		X	
Mr. Herger	X			Mr. Cardin		X	
Mr. McCrery	X			Mr. McDermott		X	
Mr. Camp	X			Mr. Lewis (GA)		X	

[42] H.R. 2661.

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Ramstad	X			Mr. Neal		X	
Mr. Nussle	X			Mr. McNulty			
Mr. Johnson	X			Mr. Jefferson		X	
Mr. English	X			Mr. Tanner		X	
Mr. Hayworth	X			Mr. Becerra		X	
Mr. Weller	X			Mr. Doggett		X	
Mr. Hulshof	X			Mr. Pomeroy		X	
Mr. Lewis (KY)	X			Ms. Tubbs Jones		X	
Mr. Foley	X			Mr. Thompson		X	
Mr. Brady	X			Mr. Larson		X	
Mr. Reynolds	X			Mr. Emanuel		X	
Mr. Ryan	X						
Mr. Cantor	X						
Mr. Linder	X						
Mr. Beauprez	X						
Ms. Hart	X						
Mr. Chocola	X						
Mr. Nunes	X						

VOTES ON AMENDMENTS

A rollcall vote was conducted on the following amendments to the Chairman's Amendment in the Nature of a Substitute.

A substitute amendment by Mr. Neal was defeated by a rollcall vote of 15 yeas to 24 nays. The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas		X		Mr. Rangel	X		
Mr. Shaw		X		Mr. Stark			
Mrs. Johnson		X		Mr. Levin	X		
Mr. Herger		X		Mr. Cardin	X		
Mr. McCrery		X		Mr. McDermott	X		
Mr. Camp		X		Mr. Lewis (GA)	X		
Mr. Ramstad		X		Mr. Neal	X		
Mr. Nussle		X		Mr. McNulty			
Mr. Johnson		X		Mr. Jefferson	X		
Mr. English		X		Mr. Tanner	X		
Mr. Hayworth		X		Mr. Becerra	X		
Mr. Weller		X		Mr. Doggett	X		
Mr. Hulshof		X		Mr. Pomeroy	X		
Mr. Lewis (KY)		X		Ms. Tubbs Jones	X		
Mr. Foley		X		Mr. Thompson	X		
Mr. Brady		X		Mr. Larson	X		
Mr. Reynolds		X		Mr. Emanuel	X		
Mr. Ryan		X					
Mr. Cantor		X					
Mr. Linder		X					
Mr. Beauprez		X					
Ms. Hart		X					
Mr. Chocola		X					
Mr. Nunes		X					

An amendment by Mr. Pomeroy, which would expand the child tax credit to include expenses paid to enforce child support obligations, was defeated by a rollcall vote of 15 yeas to 24 nays. The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas		X		Mr. Rangel	X		
Mr. Shaw		X		Mr. Stark			
Mrs. Johnson		X		Mr. Levin	X		
Mr. Herger		X		Mr. Cardin	X		
Mr. McCrery		X		Mr. McDermott	X		

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp		X		Mr. Lewis (GA)	X		
Mr. Ramstad		X		Mr. Neal	X		
Mr. Nussle		X		Mr. McNulty			
Mr. Johnson		X		Mr. Jefferson	X		
Mr. English		X		Mr. Tanner	X		
Mr. Hayworth		X		Mr. Becerra	X		
Mr. Weller		X		Mr. Doggett	X		
Mr. Hulshof		X		Mr. Pomeroy	X		
Mr. Lewis (KY)		X		Ms. Tubbs Jones	X		
Mr. Foley		X		Mr. Thompson	X		
Mr. Brady		X		Mr. Larson	X		
Mr. Reynolds		X		Mr. Emanuel	X		
Mr. Ryan		X					
Mr. Cantor		X					
Mr. Linder		X					
Mr. Beauprez		X					
Ms. Hart		X					
Mr. Chocola		X					
Mr. Nunes		X					

An amendment by Messrs. Herger, Weller, Brady, and Beauprez, which would extend increased expensing for small businesses for 2 years, was agreed to by a rollcall vote of 39 yeas to 0 nays. The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas	X			Mr. Rangel	X		
Mr. Shaw	X			Mr. Stark			
Mrs. Johnson	X			Mr. Levin	X		
Mr. Herger	X			Mr. Cardin	X		
Mr. McCrery	X			Mr. McDermott	X		
Mr. Camp	X			Mr. Lewis (GA)	X		
Mr. Ramstad	X			Mr. Neal	X		
Mr. Nussle	X			Mr. McNulty			
Mr. Johnson	X			Mr. Jefferson	X		
Mr. English	X			Mr. Tanner	X		
Mr. Hayworth	X			Mr. Becerra	X		
Mr. Weller	X			Mr. Doggett	X		
Mr. Hulshof	X			Mr. Pomeroy	X		
Mr. Lewis (KY)	X			Ms. Tubbs Jones	X		
Mr. Foley	X			Mr. Thompson	X		
Mr. Brady	X			Mr. Larson	X		
Mr. Reynolds	X			Mr. Emanuel	X		
Mr. Ryan	X						
Mr. Cantor	X						
Mr. Linder	X						
Mr. Beauprez	X						
Ms. Hart	X						
Mr. Chocola	X						
Mr. Nunes	X						

An amendment by Committee Members Camp, N. Johnson, Herger, McCrery, S. Johnson, English, Hayworth, Weller, Hulshof, and Brady, which would extend and expand the research and experimentation tax credit for 1 year, was agreed to by a rollcall vote of 39 yeas to 0 nays. The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas	X			Mr. Rangel	X		
Mr. Shaw	X			Mr. Stark			
Mrs. Johnson	X			Mr. Levin	X		
Mr. Herger	X			Mr. Cardin	X		
Mr. McCrery	X			Mr. McDermott	X		

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp	X			Mr. Lewis (GA)	X		
Mr. Ramstad	X			Mr. Neal	X		
Mr. Nussle	X			Mr. McNulty			
Mr. Johnson	X			Mr. Jefferson	X		
Mr. English	X			Mr. Tanner	X		
Mr. Hayworth	X			Mr. Becerra	X		
Mr. Weller	X			Mr. Doggett	X		
Mr. Hulshof	X			Mr. Pomeroy	X		
Mr. Lewis (KY)	X			Ms. Tubbs Jones	X		
Mr. Foley	X			Mr. Thompson	X		
Mr. Brady	X			Mr. Larson	X		
Mr. Reynolds	X			Mr. Emanuel	X		
Mr. Ryan	X						
Mr. Cantor	X						
Mr. Linder	X						
Mr. Beauprez	X						
Ms. Hart	X						
Mr. Chocola	X						
Mr. Nunes	X						

An amendment by Mr. Foley, which would extend the saver's credit for 2 years, was agreed to by a rollcall vote of 39 yeas to 0 nays. The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas	X			Mr. Rangel	X		
Mr. Shaw	X			Mr. Stark			
Mrs. Johnson	X			Mr. Levin	X		
Mr. Herger	X			Mr. Cardin	X		
Mr. McCrery	X			Mr. McDermott	X		
Mr. Camp	X			Mr. Lewis (GA)	X		
Mr. Ramstad	X			Mr. Neal	X		
Mr. Nussle	X			Mr. McNulty			
Mr. Johnson	X			Mr. Jefferson	X		
Mr. English	X			Mr. Tanner	X		
Mr. Hayworth	X			Mr. Becerra	X		
Mr. Weller	X			Mr. Doggett	X		
Mr. Hulshof	X			Mr. Pomeroy	X		
Mr. Lewis (KY)	X			Ms. Tubbs Jones	X		
Mr. Foley	X			Mr. Thompson	X		
Mr. Brady	X			Mr. Larson	X		
Mr. Reynolds	X			Mr. Emanuel	X		
Mr. Ryan	X						
Mr. Cantor	X						
Mr. Linder	X						
Mr. Beauprez	X						
Ms. Hart	X						
Mr. Chocola	X						
Mr. Nunes	X						

VOTES ON PROCEDURAL MOTIONS

A motion by Mr. Shaw to limit debate for Republicans and Democrats to 6 minutes per side was agreed to by a rollcall vote of 24 yeas to 15 nays. The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Thomas	X			Mr. Rangel		X	
Mr. Shaw	X			Mr. Stark			
Mrs. Johnson	X			Mr. Levin		X	
Mr. Herger	X			Mr. Cardin		X	
Mr. McCrery	X			Mr. McDermott		X	
Mr. Camp	X			Mr. Lewis (GA)		X	
Mr. Ramstad	X			Mr. Neal		X	

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Nussle	X			Mr. McNulty			
Mr. Johnson	X			Mr. Jefferson		X	
Mr. English	X			Mr. Tanner		X	
Mr. Hayworth	X			Mr. Becerra		X	
Mr. Weller	X			Mr. Doggett		X	
Mr. Hulshof	X			Mr. Pomeroy		X	
Mr. Lewis (KY)	X			Ms. Tubbs Jones		X	
Mr. Foley	X			Mr. Thompson		X	
Mr. Brady	X			Mr. Larson		X	
Mr. Reynolds	X			Mr. Emanuel		X	
Mr. Ryan	X						
Mr. Cantor	X						
Mr. Linder	X						
Mr. Beauprez	X						
Ms. Hart	X						
Mr. Chocola	X						
Mr. Nunes	X						

V. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d)(2) of the rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the revenue provisions of the bill, H.R. 4297, as reported.

The bill is estimated to have the following effects on budget receipts for fiscal years 2006–2010:

ESTIMATED REVENUE EFFECTS OF H.R. 4297,
THE "TAX RELIEF EXTENSION RECONCILIATION ACT OF 2005,"
AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS

Fiscal Years 2006 - 2015

[Millions of Dollars]

Provision	Effective	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-10	2006-15
I. Extension and Modification of Certain Provisions Through 2006													
1. Treatment of nonrefundable personal credits under the individual alternative minimum tax (sunset 12/31/06) [1]	tyba 12/31/05	-565	-2,260	---	---	---	---	---	---	---	---	-2,825	-2,825
2. Tax incentives for business activities on Indian reservations:													
a. Indian employment tax credit (sunset 12/31/06)	tyba 12/31/05	-21	-29	-11	-1	---	---	---	---	---	---	-62	-62
b. Accelerated depreciation for business property on Indian reservations (sunset 12/31/06)	ppisa 12/31/05	-161	-280	-104	23	77	120	98	52	6	-10	-445	-179
3. Extend and modify the work opportunity tax credit (sunset 12/31/06)	wpoifibwa 12/31/05	-125	-193	-87	-38	-23	-13	-2	---	---	---	-466	-480
4. Welfare-to-work tax credit (sunset 12/31/06)	wpoifibwa 12/31/05	-12	-27	-24	-12	-6	-3	-1	[2]	---	---	-80	-85
5. Enhanced deduction for qualified computer contributions (sunset 12/31/06)	cmd tyba 12/31/05	-66	-55	---	---	---	---	---	---	---	---	-121	-121
6. Availability of Archer medical savings accounts (sunset 12/31/06)	DOE	- - - - - - - - - - - - - - - - Negligible Revenue Effect - - - - - - - - - - - - - - - -											
7. 15-year straight-line cost recovery for qualified leasehold improvements (sunset 12/31/06)	ppisa 12/31/05	-46	-138	-181	-177	-171	-155	-146	-155	-152	-150	-714	-1,472
8. 15-year straight-line cost recovery for qualified restaurant improvements (sunset 12/31/06)	ppisa 12/31/05	-22	-56	-68	-68	-68	-67	-67	-65	-63	-57	-283	-601
9. Suspension of 100 percent-of-net-income limitation on percentage depletion for oil and gas from marginal wells (sunset 12/31/06)	tyba 12/31/05	-46	-25	---	---	---	---	---	---	---	---	-70	-70
10. Tax incentives for investment in the District of Columbia (sunset 12/31/06) [3]	tyba 12/31/05	-58	-30	-2	-1	-4	-13	-46	-23	-21	-23	-95	-221
11. Possession tax credit with respect to American Samoa (sunset tyba 12/31/06)	tyba 12/31/05	-2	-8	---	---	---	---	---	---	---	---	-10	-10
12. Parity in the application of certain limits to mental health benefits (sunset 12/31/06) [4]	DOE	-3	-45	-10	---	---	---	---	---	---	---	-58	-58
13. Extend and modify the research credit (sunset 12/31/06)	apoia 12/31/05 & tyea DOE	-3,330	-3,219	-1,480	-1,097	-740	-192	---	---	---	---	-9,866	-10,057
14. Qualified zone academy bonds (sunset 12/31/06)	bia 12/31/05	-3	-7	-14	-19	-20	-20	-20	-20	-20	-20	-62	-162
15. Above-the-line deduction for teacher classroom expenses capped at $250 annually (sunset 12/31/06)	epoi tyba 12/31/05	-60	-139	---	---	---	---	---	---	---	---	-199	-199
16. Deduction for qualified tuition and related expenses (sunset 12/31/06)	pmi tyba 12/31/05	-420	-1,260	---	---	---	---	---	---	---	---	-1,680	-1,680
17. Deduction of State and local general sales taxes (sunset 12/31/06)	tyba 12/31/05	-525	-1,574	---	---	---	---	---	---	---	---	-2,099	-2,099
Total of Extension and Modification of Certain Provisions Through 2006		**-5,465**	**-9,345**	**-1,981**	**-1,390**	**-955**	**-343**	**-184**	**-211**	**-250**	**-260**	**-19,135**	**-20,381**

Provision	Effective	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-10	2006-15
II. Extensions of Certain Provisions for Two Additional Years, and Other Modifications													
1. Extend and expand to petroleum products the expensing of "Brownfields" environmental remediation costs (sunset 12/31/07)	epoia 12/31/05	-219	-375	-130	47	54	56	49	44	38	32	-625	-406
2. Controlled foreign corporations:													
a. Exception under subpart F for active financing income (sunset 12/31/08)	[5]	---	-775	-2,339	-1,682	---	---	---	---	---	---	-4,796	-4,796
b. Look-through treatment of payments between related CFCs under foreign personal holding company income rules (sunset 12/31/08)	[6]	-82	-237	-260	-167	---	---	---	---	---	---	-746	-746
3. Tax capital gains and dividends with a 15%/0% rate structure:													
a. Capital gains (sunset 12/31/10)	tyba 12/31/08	---	---	-1,549	-8,375	2,672	-54	-12,698	[2]	[2]	---	-7,252	-20,004
b. Dividends (sunset 12/31/10)	tyba 12/31/08	---	---	-860	-4,431	-8,008	-9,368	-6,326	-1,224	-450	-112	-13,299	-30,779
4. Credit for elective deferrals and IRA contributions (sunset 12/31/08)	tyba 12/31/06	---	-481	-1,428	-903	-10	-11	-11	-11	-10	-10	-2,823	-2,875
5. Increase section 179 expensing from $25,000 to $100,000 and increase the phaseout threshold amount from $200,000 to $400,000; include software in section 179 property; and extend indexing of both the deduction limit and the phaseout threshold (sunset 12/31/09)	tyba 12/31/07	---	---	-2,605	-4,459	-209	2,707	1,772	1,222	826	476	-7,274	-271
Total of Extensions of Certain Provisions for Two Additional Years, and Other Modifications		**-301**	**-1,868**	**-9,171**	**-19,970**	**-5,501**	**-6,670**	**-17,214**	**31**	**404**	**386**	**-36,815**	**-59,877**
III. Other Provisions													
1. Taxation of certain settlement funds (sunset 12/31/10)	aafca DOE	-3	-9	-10	-11	-12	-13	-14	-15	-15	-15	-45	-117
2. Modify rules for distributions of controlled corporations (sunset 12/31/10)	generally da DOE	-1	-7	-8	-8	-9	-9	-5	-3	-1	---	-33	-51
3. Expand the qualified veterans' mortgage bond program (sunset 12/31/10)	bia 12/31/05	[2]	-1	-2	-4	-7	-8	-9	-9	-9	-9	-14	-58
4. Provide capital gains treatment for certain self-created musical works (sunset 12/31/10)	soei tyba DOE	-1	-4	-5	-5	-4	-2	-4	---	---	---	-19	-25
5. Expand the eligibility for the tonnage tax election (minimum of 6,000 deadweight tons) (sunset taxable years ending before 1/1/11)	tyba 12/31/05	-2	-3	-4	-4	-4	-3	---	---	---	---	-17	-20
6. Modification of certain arbitrage rules for certain funds (include 20% State limitation) (sunset 8/31/09)	bia DOE	---	---	-1	-2	-1	[2]	[2]	---	---	---	-4	-5
Total of Other Provisions		**-7**	**-24**	**-30**	**-34**	**-37**	**-35**	**-32**	**-27**	**-25**	**-24**	**-132**	**-276**
NET TOTAL		**-5,773**	**-11,237**	**-11,182**	**-21,394**	**-6,493**	**-7,048**	**-17,430**	**-207**	**129**	**102**	**-56,082**	**-80,534**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be December 1, 2005.

[Legend and Footnotes for the Table appear on the following page]

Legend and Footnotes for the Table:

Legend for "Effective" column:

aafca = accounts and fund created after
apoia = amounts paid or incurred after
bia = bonds issued after
cmd = contributions made during
da = distributions after
epoi = expenses paid or incurred in
epoia = expenses paid or incurred after
DOE = date of enactment
pmi = payments made in
ppisa = property placed in service after
soei = sales or exchanges in
tyba = taxable years beginning after
wpoifibwa = wages paid or incurred for individuals beginning work after

[1] The "Economic Growth and Tax Relief Reconciliation Act of 2001" provides that the child tax credit and adoption tax credit are allowed for purposes of the alternative minimum tax for 2002 through 2010.
[2] Loss of less than $500,000.
[3] The extension of tax-exempt financing is effective for bonds issued after the date of enactment.
[4] This provision will have a negligible effect on penalty excise tax receipts. However it will have an indirect effect on income tax receipts through increases in employer-contributions for health insurance and corresponding decreases in cash wages. The table shows this indirect revenue effect, which was estimated by the Congressional Budget Office.
[5] Effective for taxable years of foreign corporations beginning after December 31, 2006, and before January 1, 2009, and to taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.
[6] Effective for taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2009, and to taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue reducing tax provisions involve increased tax expenditures and budget outlays. (See amounts in table in Part IV.A., above.)

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives requires a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, November 17, 2005.

Hon. William "Bill" M. Thomas,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: Based on a review of H.R. 4297, the Tax Relief Extension Reconciliation Act of 2005, as ordered reported by the Committee on Ways and Means on November 15, 2005, CBO and the Joint Committee on Taxation (JCT) estimate that enacting this legislation would reduce revenues by $56.1 billion over the 2006–2010 period and by $80.5 billion over the 2006–2015 period. In addition, CBO estimates that this legislation would have no effect on federal spending. The estimated revenue effects are summarized below. A table with additional details is attached.

	By fiscal year, in millions of dollars—											
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006–2010	2006–2015
Estimated Revenues [1]	−5,773	−11,237	−11,182	−21,394	−6,493	−7,048	−17,430	−207	129	102	−56,082	−80,535
On-Budget	−5,772	−11,224	−11,179	−21,394	−6,493	−7,048	−17,430	−207	129	102	−56,065	−80,518
Off-Budget	−1	−14	−3	0	0	0	0	0	0	0	−17	−17

[1] The estimates assume the bill will be enacted by December 1, 2005.
Sources: CBO and the Joint Committee on Taxation.

Most of the reduction in revenues would result from extending the reduced tax rates for dividends and capital gains. Those provisions account for $50.8 billion of the estimated reduction in revenues over the 10-year period, JCT provided all of the revenue estimates with the exception of the estimate for the provision that extends increased limits for mental health parity. CBO estimates that the one-year extension of those increased limits would reduce revenues by $58 million over the 2006–2008 period. (Of that reduction, $17 million would apply to off budget receipts.)

JCT has reviewed H.R. 4297 and has determined that it contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Emily Schlect.

Sincerely,

ROBERT A. SUNSHINE
(For Douglas Holtz-Eakin, Director).

Attachment.

ESTIMATED EFFECTS ON REVENUES FOR S.R. 4297

	By fiscal year, in millions of dollars—									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
CHANGES IN REVENUES										
Extension of the Reduced Tax Rates for Dividends	0	0	−860	−4,431	−8,008	−9,368	−6,326	−1,224	−450	−112
Extension of the Reduced Tax Rates for Capital Gains	0	0	−1,549	−8,375	2,672	−54	−12,698	*	*	0
Extension and Modification of the Research Credit	−3,330	−3,219	−1,480	−1,097	−740	−192	0	0	0	0
Extension of the Exception for Active Financing Income for Controlled Foreign Corporations	0	−775	−2,339	−1,682	0	0	0	0	0	0
Extension of the Credit for Elective Deferrals and IRA Contributions	0	−481	−1,428	−903	−10	−11	−11	−11	−10	−10
Extension of Non-refundable Personal Credits under the Alternative Minimum Tax	−565	−2,260	0	0	0	0	0	0	0	0
Extension of the Deduction for State and Local Sales Taxes	−525	−1,574	0	0	0	0	0	0	0	0
Extension of the Deduction for Qualified Tuition	−420	−1,260	0	0	0	0	0	0	0	0
Extension of Cost Recovery for, Qualified Leasehold Improvements	−46	−138	−181	−177	−171	−155	−146	−155	−152	−150
Extension of the Increase in Section 179 Expensing	0	0	−2,605	−4,459	−209	2,707	1,772	1,222	826	476
All Other Provisions	−887	−1.530	−740	—270	−27	25	−21,	−39	−85	−102
Total	−5,773	−11,237	−11,182	−21,394	−6,493	−7,048	−17,430	−207	129	102
On-Budget	−5,772	−11,224	−11,179	−21,394	−6,493	−7,048	−17,430	−207	129	102
Off-Budget [1]	−1	−14	−3	0	0	0	0	0	0	0

[1] The provision that provides parity in the application of certain limits to mental health benefits, which is included in the estimate for all other provisions, affects both on- and off-budget revenues.

Sources: CBO and the Joint Committee on Taxation.
Note: * = Loss of less than $500,000

D. MACROECONOMIC IMPACT ANALYSIS

In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986. In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made by the staff of the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986.

This bill contains provisions that would temporarily lower the after-tax cost of capital, providing incentives for additional investment in productive capital, which will likely result in a small increase in economic growth. They include the two-year extensions of reductions in the rate of taxation of dividends and realized capital gains, the two-year extension of the changes to section 179 expensing, and the one-year extension and revision of the tax credit for research and experimentation. These provisions represent small changes in the after-tax cost of capital. The temporary nature of these incentives increases the amount of uncertainty associated with modeling the effects of these proposals on the macro-economy. Modeling the effects of such proposals requires making assumptions about taxpayers' expectations about the future of these proposals, as well as adjusting their responses in light of those assumptions. Empirical evidence on taxpayers' expectations about future tax policy and likely response to temporary incentives is inconclusive. The expected effects of these provisions on timing of investment have been incorporated in the conventional revenue estimates for these proposals. While we estimate that these provisions would have a positive effect on economic growth, that effect is small relative to the amount of uncertainty associated with this estimate.

In addition, this bill contains a number of provisions differentially affecting both corporate and non-corporate businesses as well as differentially affecting small sub-sectors of the economy. The resulting re-allocation of relative tax burden among these different business sectors could have positive or negative implications for economic efficiency, and hence, long-term growth. The size of these provisions is also small in relation to the U.S. economy. Finally, the net increase in the U.S. Federal government deficit is likely to crowd out some domestic investment in the long run.

Thus, we estimate that the effects of the bill on economic activity are so small relative to the size of the economy and the degree of uncertainty associated with the estimate as to be incalculable within the context of a model of the aggregate economy.

VI. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. COMMITTEE OVERSIGHT FINDINGS AND RECOMMENDATIONS

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that the bill was a result of the Committee's budget reconciliation instructions.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Constitutional Authority Statement

With respect to clause 3(d)(1) of the rule XIII of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 8 ("The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises . . ."), and from the 16th Amendment to the Constitution.

D. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the revenue provisions of the bill do not contain Federal mandates on the private sector. The Committee has determined that the revenue provision of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

E. Applicability of House Rule XXI 5(b)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increases within the meaning of the rule.

F. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service ("IRS") and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code (the "Code") and has widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and Treasury regarding each of the provisions included in the complexity analysis.

Capital gain and dividend rate reduction (sec. 203 of the bill)

Summary description of proposal

The bill extends the zero-and 15-percent capital gain and dividend rates to taxable years beginning in 2009 and 2010.

Number of affected taxpayers

It is estimated that the provision will affect 33 million individual tax returns.

Discussion

The extension of the provision means that for 2009 and 2010 individual taxpayers and the IRS will continue to use the same forms for capital gains and dividends.

The extension of the lower rates for net capital gain will achieve simplification because the extension prevents the separate five-year holding periods from going into effect in 2009 and 2010. On the other hand, the extension of the lower rates for dividends will continue requiring dividends to be classified as qualified dividends and nonqualified dividends in 2009 and 2010 and will continue to require the tax to be computed using the capital gains forms.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC.

Mr. GEORGE K. YIN,
Chief of Staff, Joint Committee on Taxation,
Washington, DC.

DEAR MR. YIN: Enclosed are the combined comments of the Internal Revenue Service and the Treasury Department on the provision extending the zero and 15-percent tax rates for capital gains and qualified dividends of individuals to taxable years beginning in 2009 and 2010, from the Tax Relief Extension Act of 2005 (H.R. 4297) approved by the House Committee on Ways and Means November 15, that you identified for complexity analysis in your letter of November 16.

Our comments are based on the statutory language for that provision contained in H.R. 4297 and the description of that provision provided in your letter. Due to the short turnaround time, our comments are provisional and subject to change upon a more complete and in-depth analysis of the provision.

Sincerely,

MARK W. EVERSON,
Commissioner.

Enclosure.

COMPLEXITY ANALYSIS OF THE TAX RELIEF EXTENSION RECONCILIATION ACT OF 2005 (H.R. 4297)

Extension of the Zero and 15-Percent Tax Rates for Adjusted Net Capital Gain

Provision: Under present law, for taxable years beginning before 2009, the maximum rate of tax on the adjusted net capital gain of an individual is 15%. Any adjusted net capital gain which otherwise would be taxed at a 10% or 15% rate is taxed at a 5% rate (zero for taxable years beginning after 2007). Qualified dividends received by an individual from domestic corporations and qualified foreign corporations are included in adjusted net capital gain and thus are also taxed at the 15%, 5%, or zero rates. These rates apply for purposes of both the regular tax and the alternative minimum tax. For taxable years beginning after 2008, the tax rates on adjusted net capital gain will be higher—20% or 10% for net capital gain and up to 35% for dividends.

The provision extends the zero and 15% tax rates for adjusted net capital gain (including qualified dividends) of individuals for two years (to taxable years beginning in 2009 and 2010).

IRS and Treasury comments

- Filers of Forms 1040, 1040A, and 1040NR would have to continue to report qualified dividends on a separate line in 2009 and 2010 that otherwise would have been eliminated.
- Two lines used to increase net capital gain by the amount of qualified dividends would remain on the Qualified Dividends and Capital Gain Tax Worksheet and the Schedule D Tax Worksheet in the instructions for the 2009 and 2010 Forms 1040, 1040A, and 1040NR.
- Because the 8% and 18% capital gains tax rates on qualified 5-year gain would not become effective until 2011, this provision would eliminate the need for: (a) a 12-line Qualified 5-Year Gain Worksheet to the Instructions for Schedule D (Form 1040) for 2009 and 2010, (b) eight lines to the Qualified Dividends and Capital Gain Tax Worksheet, the Schedule D Tax Worksheet, and Form 6251 for 2009 and 2010, (c) two lines to Schedule D (Form 1040) for 2009 and 2010, and (d) eight lines to Form 8801 for 2010 and 2011.
- Form 1099–DIV filers would have to continue to report qualified dividends in 2009 and 2010, thus requiring retention of a line that otherwise would have been eliminated.
- Form 1099–DIV filers would not be required to report qualified 5-year gain eligible for the 8% and 18% rates in 2009 or 2010. This would eliminate the need for two additional lines on Form 1099–DIV for 2009 and 2010.
- Form 1041 and its equivalent worksheets would be affected in a similar manner to that explained above for Form 1040.
- The programming changes that IRS would have had to make to reflect the higher 2009 tax rates applicable to dividends and capital gains absent the provision would be deferred to 2011.

VII. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rule of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

* * * * * * *

Subtitle A—Income Taxes

* * * * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * * * *

Subchapter A—Determination of Tax Liability

* * * * * * *

PART IV—CREDITS AGAINST TAX

* * * * * * *

Subpart A—Nonrefundable Personal Credits

* * * * * * *

SEC. 25B. ELECTIVE DEFERRALS AND IRA CONTRIBUTIONS BY CERTAIN INDIVIDUALS.

(a) * * *

* * * * * * *

(h) TERMINATION.—This section shall not apply to taxable years beginning after December 31, ⟦2006⟧ *2008*.

SEC. 26. LIMITATION BASED ON TAX LIABILITY; DEFINITION OF TAX LIABILITY.

(a) LIMITATION BASED ON AMOUNT OF TAX.—

(1) * * *

(2) SPECIAL RULE FOR TAXABLE YEARS 2000 THROUGH ⟦2005⟧ *2006*.—For purposes of any taxable year beginning during during 2000, 2001, 2002, 2003, 2004, ⟦or 2005⟧ *2005, or 2006*, the aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the sum of—

(A) * * *

* * * * * * *

Subpart D—Business Related Credits

* * * * * * *

SEC. 41. CREDIT FOR INCREASING RESEARCH ACTIVITIES.

(a) * * *

* * * * * * *

(c) BASE AMOUNT.—

(1) * * *

* * * * * * *

(4) ELECTION OF ALTERNATIVE INCREMENTAL CREDIT.—

(A) IN GENERAL.—At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to the sum of—

(i) ⟦2.65⟧ *3* percent of so much of the qualified research expenses for the taxable year as exceeds 1 percent of the average described in subsection (c)(1)(B) but does not exceed 1.5 percent of such average,

(ii) ⟦3.2⟧ *4* percent of so much of such expenses as exceeds 1.5 percent of such average but does not exceed 2 percent of such average, and

(iii) ⟦3.75⟧ *5* percent of so much of such expenses as exceeds 2 percent of such average.

(B) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary. *An election under this paragraph may not be made for any taxable year to which an election under paragraph (5) applies.*

* * * * * * *

(5) ELECTION OF ALTERNATIVE SIMPLIFIED CREDIT.—

(A) IN GENERAL.—At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to 12 percent of so much of the qualified research expenses for the taxable year as exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

(B) SPECIAL RULE IN CASE OF NO QUALIFIED RESEARCH EXPENSES IN ANY OF 3 PRECEDING TAXABLE YEARS.—

(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The credit under this paragraph shall be determined under this subparagraph if the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined.

(ii) CREDIT RATE.—The credit determined under this subparagraph shall be equal to 6 percent of the qualified research expenses for the taxable year.

(C) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary. An election under this paragraph may not be made for any taxable year to which an election under paragraph (4) applies.

⟦(5)⟧ *(6)* CONSISTENT TREATMENT OF EXPENSES REQUIRED.—

(A) * * *

* * * * * * *

[(6)] *(7)* GROSS RECEIPTS.—For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

* * * * * * *

(h) TERMINATION.—

(1) IN GENERAL.—This section shall not apply to any amount paid or incurred—

(A) after June 30, 1995, and before July 1, 1996, or

(B) after December 31, [2005] *2006*.

* * * * * * *

SEC. 45A. INDIAN EMPLOYMENT CREDIT.

(a) * * *

* * * * * * *

(f) TERMINATION.—This section shall not apply to taxable years beginning after December 31, [2005] *2006*.

* * * * * * *

SEC. 45C. CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES OR CONDITIONS.

(a) * * *

(b) QUALIFIED CLINICAL TESTING EXPENSES.—For purposes of this section—

(1) QUALIFIED CLINICAL TESTING EXPENSES.—

(A) * * *

* * * * * * *

(D) SPECIAL RULE.—For purposes of this paragraph, section 41 shall be deemed to remain in effect for periods after June 30, 1995, and before July 1, 1996, and periods after December 31, [2005] *2006*.

* * * * * * *

Subpart F—Rules for Computing Work Opportunity Credit

* * * * * * *

SEC. 51. AMOUNT OF CREDIT.

(a) * * *

* * * * * * *

(c) WAGES DEFINED.—For purposes of this subpart—

(1) * * *

* * * * * * *

(4) TERMINATION.—The term "wages" shall not include any amount paid or incurred to an individual who begins work for the employer—

(A) * * *

(B) after December 31, [2005] *2006*.

* * * * * * *

(d) MEMBERS OF TARGETED GROUPS.—For purposes of this subpart—

(1) * * *

* * * * * * *

(8) QUALIFIED FOOD STAMP RECIPIENT.—

(A) IN GENERAL.—The term "qualified food stamp recipient" means any individual who is certified by the designated local agency—

(i) as having attained age 18 but not age [25] *35* on the hiring date, and

* * * * * * *

SEC. 51A. TEMPORARY INCENTIVES FOR EMPLOYING LONG-TERM FAMILY ASSISTANCE RECIPIENTS.

(a) * * *

* * * * * * *

(f) TERMINATION.—This section shall not apply to individuals who begin work for the employer after December 31, [2005] *2006*.

* * * * * * *

Subchapter B—Computation of Taxable Income

* * * * * * *

PART I—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, TAXABLE INCOME, ETC.

* * * * * * *

SEC. 62. ADJUSTED GROSS INCOME DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:

(1) * * *

(2) CERTAIN TRADE AND BUSINESS DEDUCTIONS OF EMPLOYEES.—

(A) * * *

* * * * * * *

(D) CERTAIN EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS.—In the case of taxable years beginning during 2002 , 2003, 2004, [or 2005] *2005, or 2006*, the deductions allowed by section 162 which consist of expenses, not in excess of $250, paid or incurred by an eligible educator in connection with books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom.

* * * * * * *

PART IV—TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS

* * * * * * *

Subpart A—Private Activity Bonds

* * * * * * *

SEC. 143. MORTGAGE REVENUE BONDS: QUALIFIED MORTGAGE BOND AND QUALIFIED VETERANS' MORTGAGE BOND.

(a) * * *

* * * * * * *

(l) ADDITIONAL REQUIREMENTS FOR QUALIFIED VETERANS' MORTGAGE BONDS.—An issue meets the requirements of this subsection only if it meets the requirements of paragraphs (1), (2), and (3).

(1) * * *

* * * * * * *

(3) VOLUME LIMITATION.—

(A) * * *

⟦(B) STATE VETERANS LIMIT.—A State veterans limit for any calendar year is the amount equal to—

⟦(i) the aggregate amount of qualified veterans bonds issued by such State during the period beginning on January 1, 1979, and ending on June 22, 1984 (not including the amount of any qualified veterans bond issued by such State during the calendar year (or portion thereof) in such period for which the amount of such bonds so issued was the lowest), divided by

⟦(ii) the number (not to exceed 5) of calendar years after 1979 and before 1985 during which the State issued qualified veterans bonds (determined by only taking into account bonds issued on or before June 22, 1984).⟧

(B) STATE VETERANS LIMIT.—

(i) IN GENERAL.—A State veterans limit for any calendar year is the amount equal to—

(I) $53,750,000 for the State of Texas,

(II) $66,250,000 for the State of California,

(III) $25,000,000 for the State of Oregon,

(IV) $25,000,000 for the State of Wisconsin, and

(V) $25,000,000 for the State of Alaska.

(ii) PHASEIN.—In the case of calendar years beginning before 2010, clause (i) shall be applied by substituting for each of the dollar amounts therein by the applicable percentage. For purposes of the preceding sentence, the applicable percentage shall be determined in accordance with the following table:

Calendar Year:	*Applicable percentage is:*
2006	*20 percent*
2007	*40 percent*
2008	*60 percent*
2009	*80 percent.*

(iii) TERMINATION.—The State veterans limit for any calendar year after 2010 is zero.

(4) QUALIFIED VETERAN.—For purposes of this subsection, the term "qualified veteran" means any veteran—

(A) who served on active duty ❲at some time before January 1, 1977❳, and

❲(B) who applied for the financing before the later of—

❲(i) the date 30 years after the last date on which such veteran left active service, or

❲(ii) January 31, 1985.❳

(B) who applied for the financing before the date 25 years after the last date on which such veteran left active service.

* * * * * * *

PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

* * * * * * *

SEC. 164. TAXES.

(a) * * *

(b) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) * * *

* * * * * * *

(5) GENERAL SALES TAX.—For purposes of subsection (a)—

(A) * * *

* * * * * * *

(I) APPLICATION OF PARAGRAPH.—This paragraph shall apply to taxable years beginning after December 31, 2003, and before January 1, ❲2006❳ *2007*.

* * * * * * *

SEC. 168. ACCELERATED COST RECOVERY SYSTEM

(a) * * *

* * * * * * *

(e) CLASSIFICATION OF PROPERTY.—For purposes of this section—

(1) * * *

* * * * * * *

(3) CLASSIFICATION OF CERTAIN PROPERTY.—

(A) * * *

* * * * * * *

(E) 15-YEAR PROPERTY.—The term "15-year property" includes—

(i) * * *

* * * * * * *

(iv) any qualified leasehold improvement property placed in service before January 1, ❲2006❳ *2007*,

(v) any qualified restaurant property placed in service before January 1, ❲2006❳ *2007*,

* * * * * * *

(j) PROPERTY ON INDIAN RESERVATIONS.—

(1) * * *

* * * * * * *

(8) TERMINATION.—This subsection shall not apply to property placed in service after December 31, [2005] *2006*.

* * * * * * *

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) * * *

* * * * * * *

(e) CERTAIN CONTRIBUTIONS OF ORDINARY INCOME AND CAPITAL GAIN PROPERTY.—

(1) GENERAL RULE.—The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of—

(A) the amount of gain which would not have been long-term capital gain *(determined without regard to section 1221(b)(3))* if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution), and

* * * * * * *

(6) SPECIAL RULE FOR CONTRIBUTIONS OF COMPUTER TECHNOLOGY AND EQUIPMENT FOR EDUCATIONAL PURPOSES.—

(A) * * *

* * * * * * *

(G) TERMINATION.—This paragraph shall not apply to any contribution made during any taxable year beginning after December 31, [2005] *2006*.

* * * * * * *

SEC. 179. ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS.

(a) * * *

(b) LIMITATIONS.—

(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $25,000 ($100,000 in the case of taxable years beginning after 2002 and before [2008] *2010*).

(2) REDUCTION IN LIMITATION.—The limitation under paragraph (1) for any taxable year shall be reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during such taxable year exceeds $200,000 ($400,000 in the case of taxable years beginning after 2002 and before [2008] *2010*).

* * * * * * *

(5) INFLATION ADJUSTMENTS.—

(A) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2003 and before [2008] *2010*, the $100,000 and $400,000 amounts in paragraphs (1) and (2) shall each be increased by an amount equal to—

(i) * * *

* * * * * * *

(c) ELECTION.—

(1) * * *

(2) ELECTION IRREVOCABLE.—Any election made under this section, and any specification contained in any such election, may not be revoked except with the consent of the Secretary. Any such election or specification with respect to any taxable year beginning after 2002 and before [2008] *2010* may be revoked by the taxpayer with respect to any property, and such revocation, once made, shall be irrevocable.

(d) DEFINITIONS AND SPECIAL RULES.—

(1) SECTION 179 PROPERTY.—For purposes of this section, the term "section 179 property" means property—

(A) which is—

(i) * * *

(ii) computer software (as defined in section 197(e)(3)(B)) which is described in section 197(e)(3)(A)(i), to which section 167 applies, and which is placed in service in a taxable year beginning after 2002 and before [2008] *2010*,

* * * * * * *

PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

* * * * * * *

SEC. 198. EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.

(a) * * *

* * * * * * *

(d) HAZARDOUS SUBSTANCE.—For purposes of this section—

(1) IN GENERAL.—The term "hazardous substance" means—

(A) any substance which is a hazardous substance as defined in section 101(14) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, [and]

(B) any substance which is designated as a hazardous substance under section 102 of such Act[.]*, and*

(C) any petroleum product (as defined in section 4612(a)(3)).

* * * * * * *

(h) TERMINATION.—This section shall not apply to expenditures paid or incurred after December 31, [2005] *2007*.

* * * * * * *

PART VII—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

* * * * * * *

SEC. 220. ARCHER MSAS.

(a) * * *

* * * * * * *

(i) LIMITATION ON NUMBER OF TAXPAYERS HAVING ARCHER MSAS.—

(1) * * *

(2) CUT-OFF YEAR.—For purposes of paragraph (1), the term "cut-off year" means the earlier of

(A) calendar year [2005] *2006*, or

(B) the first calendar year before [2005] *2006* for which the Secretary determines under subsection (j) that the numerical limitation for such year has been exceeded.

(3) ACTIVE MSA PARTICIPANT.—For purposes of this subsection—

(A) * * *

(B) SPECIAL RULE FOR CUT-OFF YEARS BEFORE [2005] *2006*.—In the case of a cut-off year before [2005] *2006*—

(i) * * *

* * * * * * *

(j) DETERMINATION OF WHETHER NUMERICAL LIMITS ARE EXCEEDED.—

(1) * * *

(2) DETERMINATION OF WHETHER LIMIT EXCEEDED FOR 1998, 1999, 2001, 2002, [OR 2004] *2004, OR 2005*.—

(A) IN GENERAL.—The numerical limitation for 1998, 1999, 2001, 2002, [or 2004] *2004, or 2005* is exceeded if the sum of—

(i) * * *

* * * * * * *

(B) ALTERNATIVE COMPUTATION OF LIMITATION.—The numerical limitation for 1998, 1999, 2001, 2002, [or 2004] *2004, or 2005* is also exceeded if the sum of—

(i) * * *

* * * * * * *

(4) REPORTING BY MSA TRUSTEES.—

(A) IN GENERAL.—Not later than August 1 of 1997, 1998, 1999, 2001, 2002, [and 2004] *2004, and 2005* each person who is the trustee of an Archer MSA established before July 1 of such calendar year shall make a report to the Secretary (in such form and manner as the Secretary shall specify) which specifies—

(i) * * *

* * * * * * *

SEC. 222. QUALIFIED TUITION AND RELATED EXPENSES.

(a) * * *

(b) DOLLAR LIMITATIONS.—

(1) * * *

(2) APPLICABLE DOLLAR LIMIT.—

[(A) 2002 AND 2003.—In the case of a taxable year beginning in 2002 or 2003, the applicable dollar limit shall be equal to—

[(i) in the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), $3,000, and—

[(ii) in the case of any other taxpayer, zero.

[(B) 2004 AND 2005.—In the case of a taxable year beginning in 2004 or 2005, the applicable dollar amount shall be equal to—

⟦(i) in the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), $4,000,

⟦(ii) in the case of a taxpayer not described in clause (i) whose adjusted gross income for the taxable year does not exceed $80,000 ($160,000 in the case of a joint return), $2,000, and

⟦(iii) in the case of any other taxpayer, zero.⟧

(A) 2006.—In the case of a taxable year beginning in 2006, the applicable dollar amount shall be equal to—

(i) in the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), $4,000,

(ii) in the case of a taxpayer not described in clause (i) whose adjusted gross income for the taxable year does not exceed $80,000 ($160,000 in the case of a joint return), $2,000, and

(iii) in the case of any other taxpayer, zero.

⟦(C)⟧ *(B)* ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined—

(i) * * *

* * * * * * *

(e) TERMINATION.—This section shall not apply to taxable years beginning after December 31, ⟦2005⟧ *2006*.

* * * * * * *

Subchapter C—Corporate Distributions and Adjustments

* * * * * * *

PART III—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

* * * * * * *

Subpart B—Effects on Shareholders and Security Holders

* * * * * * *

SEC. 355. DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.

(a) * * *

(b) REQUIREMENTS AS TO ACTIVE BUSINESS.—

(1) * * *

* * * * * * *

(3) SPECIAL RULE RELATING TO ACTIVE BUSINESS REQUIREMENT.—

(A) IN GENERAL.—In the case of any distribution made after the date of the enactment of this paragraph and before December 31, 2010, a corporation shall be treated as meeting the requirement of paragraph (2)(A) if and only if such corporation is engaged in the active conduct of a trade or business.

(B) AFFILIATED GROUP RULE.—For purposes of subparagraph (A), all members of such corporation's separate affiliated group shall be treated as one corporation. For purposes of the preceding sentence, a corporation's separate affiliated group is the affiliated group which would be determined under section 1504(a) if such corporation were the common parent and section 1504(b) did not apply.

(C) TRANSITION RULE.—Subparagraph (A) shall not apply to any distribution pursuant to a transaction which is—

(i) made pursuant to an agreement which was binding on the date of the enactment of this paragraph and at all times thereafter,

(ii) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(iii) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission.

The preceding sentence shall not apply if the distributing corporation elects not to have such sentence apply to distributions of such corporation. Any such election, once made, shall be irrevocable.

(D) SPECIAL RULE FOR CERTAIN PRE-ENACTMENT DISTRIBUTIONS.—For purposes of determining the continued qualification under paragraph (2)(A) of distributions made before the date of the enactment of this paragraph as a result of an acquisition, disposition, or other restructuring after such date and before December 31, 2010, such distribution shall be treated as made after the date of the enactment of this paragraph for purposes of applying subparagraphs (A) through (C) of this paragraph.

* * * * * * *

Subchapter E—Accounting Periods and Methods of Accounting

* * * * * * *

PART II—METHODS OF ACCOUNTING

* * * * * * *

Subpart C—Taxable Year for Which Deductions Taken

* * * * * * *

SEC. 468B. SPECIAL RULES FOR DESIGNATED SETTLEMENT FUNDS.

(a) * * *

* * * * * * *

[(g) CLARIFICATION OF TAXATION OF CERTAIN FUNDS.—Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.]

(g) CLARIFICATION OF TAXATION OF CERTAIN FUNDS.—

(1) IN GENERAL.—Except as provided in paragraph (2), nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

(2) EXEMPTION FROM TAX FOR CERTAIN SETTLEMENT FUNDS.—An escrow account, settlement fund, or similar fund shall be treated as beneficially owned by the United States and shall be exempt from taxation under this subtitle if—

(A) it is established pursuant to a consent decree entered by a judge of a United States District Court,

(B) it is created for the receipt of settlement payments as directed by a government entity for the sole purpose of resolving or satisfying one or more claims asserting liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980,

(C) the authority and control over the expenditure of funds therein (including the expenditure of contributions thereto and any net earnings thereon) is with such government entity, and

(D) upon termination, any remaining funds will be disbursed to such government entity for use in accordance with applicable law.

For purposes of this paragraph, the term "government entity" means the United States, any State or political subdivision thereof, the District of Columbia, any possession of the United States, and any agency or instrumentality of any of the foregoing.

(3) TERMINATION.—Paragraph (2) shall not apply to accounts and funds established after December 31, 2010.

* * * * * * *

Subchapter I—Natural Resources

* * * * * * *

PART I—DEDUCTIONS

* * * * * * *

SEC. 613A. LIMITATIONS ON PERCENTAGE DEPLETION IN CASE OF OIL AND GAS WELLS.

(a) * * *

* * * * * * *

(c) EXEMPTION FOR INDEPENDENT PRODUCERS AND ROYALTY OWNERS.—

(1) * * *

* * * * * * *

(6) OIL AND NATURAL GAS PRODUCED FROM MARGINAL PROPERTIES.—

(A) * * *

* * * * * * *

(H) TEMPORARY SUSPENSION OF TAXABLE INCOME LIMIT WITH RESPECT TO MARGINAL PRODUCTION.—The second sentence of subsection (a) of section 613 shall not apply to so much of the allowance for depletion as is determined under subparagraph (A) for any taxable year beginning after December 31, 1997, and before January 1, ［2006］ *2007*.

* * * * * * *

Subchapter N—Tax Based on Income from Sources Within or Without the United States

* * * * * * *

PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

* * * * * * *

Subpart A—Foreign Tax Credit

* * * * * * *

SEC. 904. LIMITATION ON CREDIT.

(a) * * *

* * * * * * *

(i) COORDINATION WITH NONREFUNDABLE PERSONAL CREDITS.—In the case of an individual, for purposes of subsection (a), the tax against which the credit is taken is such tax reduced by the sum of the credits allowable under subpart A of part IV of subchapter A of this chapter (other than sections 23, 24, and 25B). This subsection shall not apply to taxable years beginning during 2000, 2001, 2002, 2003, 2004, ［or 2005］ *2005, or 2006*.

* * * * * * *

Subpart D—Possessions of the United States

* * * * * * *

SEC. 936. PUERTO RICO AND POSSESSION TAX CREDIT.

(a) * * *

* * * * * * *

(j) TERMINATION.—

(1) * * *

* * * * * * *

(8) SPECIAL RULES FOR CERTAIN POSSESSIONS.—

(A) IN GENERAL.—In the case of an existing credit claimant with respect to an applicable possession, this section (other than the preceding paragraphs of this subsection) shall apply to such claimant with respect to such applicable possession for taxable years beginning after December 31, 1995, and before January 1, 2006 *(before January 1, 2007, in the case of American Samoa)*.

* * * * * * *

Subpart F—Controlled Foreign Corporations

* * * * * * *

SEC. 953. INSURANCE INCOME.

(a) * * *

* * * * * * *

(e) EXEMPT INSURANCE INCOME.—For purposes of this section—

(1) * * *

* * * * * * *

(10) APPLICATION.—This subsection and section 954(i) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before [January 1, 2007] *January 1, 2009*, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends. If this subsection does not apply to a taxable year of a foreign corporation beginning after [December 31, 2006] *December 31, 2008* (and taxable years of United States shareholders ending with or within such taxable year), then, notwithstanding the preceding sentence, subsection (a) shall be applied to such taxable years in the same manner as it would if the taxable year of the foreign corporation began in 1998.

* * * * * * *

SEC. 954. FOREIGN BASE COMPANY INCOME.

(a) * * *

* * * * * * *

(c) FOREIGN PERSONAL HOLDING COMPANY INCOME.—

(1) * * *

* * * * * * *

(6) LOOK-THRU RULE FOR RELATED CONTROLLED FOREIGN CORPORATIONS.—

(A) IN GENERAL.—For purposes of this subsection, dividends, interest, rents, and royalties received or accrued from a controlled foreign corporation which is a related person shall not be treated as foreign personal holding company income to the extent attributable or properly allocable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is not subpart F income. For purposes of this subparagraph, interest shall include factoring income which is treated as income equivalent to interest for purposes of paragraph (1)(E). The Secretary shall prescribe such regulations as may be appropriate to prevent the abuse of the purposes of this paragraph.

(B) APPLICATION.—Subparagraph (A) shall apply to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2009, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

* * * * * * *

(h) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF BANKING, FINANCING, OR SIMILAR BUSINESSES.—

(1) * * *

* * * * * * *

(9) APPLICATION.—This subsection, subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before ❲January 1, 2007❳ *January 1, 2009*, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends.

* * * * * * *

Subchapter P—Capital Gains and Losses

* * * * * * *

PART III—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

* * * * * * *

SEC. 1221. CAPITAL ASSET DEFINED.

(a) * * *

(b) DEFINITIONS AND SPECIAL RULES.—

(1) * * *

* * * * * * *

(3) SALE OR EXCHANGE OF SELF-CREATED MUSICAL WORKS.—At the election of the taxpayer, paragraphs (1) and (3) of subsection (a) shall not apply with respect to any sale or exchange before January 1, 2011, of musical compositions or copyrights in musical works by a taxpayer described in subsection (a)(3).

❲(3)❳ *(4)* REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (6) and (7) of subsection (a) in the case of transactions involving related parties.

* * * * * * *

Subchapter R—Election To Determine Corporate Tax on Certain International Shipping Activities Using Per Ton Rate

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SEC. 1355. DEFINITIONS AND SPECIAL RULES.

(a) DEFINITIONS.—For purposes of this subchapter—

(1) * * *

* * * * * * *

(4) QUALIFYING VESSEL.—The term "qualifying vessel" means a self- propelled (or a combination self-propelled and non-self-propelled) United States flag vessel of not less than 10,000 *(6,000, in the case of taxable years beginning after December 31, 2005, and ending before January 1, 2011)* deadweight tons

used exclusively in the United States foreign trade during the period that the election under this subchapter is in effect.

* * * * * * *

Subchapter U—Designation and Treatment of Empowerment Zones, Enterprise Communities, and Rural Development Investment Areas

* * * * * * *

PART IV—INCENTIVES FOR EDUCATION ZONES

* * * * * * *

SEC. 1397E. CREDIT TO HOLDERS OF QUALIFIED ZONE ACADEMY BONDS.

(a) * * *

* * * * * * *

(e) LIMITATION ON AMOUNT OF BONDS DESIGNATED.—

(1) NATIONAL LIMITATION.—There is a national zone academy bond limitation for each calendar year. Such limitation is $400,000,000 for 1998, 1999, 2000, 2001, 2002, 2003, 2004, ⟦and 2005⟧ *2005, and 2006* and, except as provided in paragraph (4), zero thereafter.

* * * * * * *

Subchapter W—District of Columbia Enterprise Zone

* * * * * * *

SEC. 1400. ESTABLISHMENT OF DC ZONE.

(a) * * *

* * * * * * *

(f) TIME FOR WHICH DESIGNATION APPLICABLE.—

(1) IN GENERAL.—The designation made by subsection (a) shall apply for the period beginning on January 1, 1998, and ending on ⟦December 31, 2005⟧ *December 31, 2006*.

(2) COORDINATION WITH DC ENTERPRISE COMMUNITY DESIGNATED UNDER SUBCHAPTER U.—The designation under subchapter U of the census tracts referred to in subsection (b)(1) as an enterprise community shall terminate on ⟦December 31, 2005⟧ *December 31, 2006*.

* * * * * * *

SEC. 1400A. TAX-EXEMPT ECONOMIC DEVELOPMENT BONDS.

(a) * * *

(b) PERIOD OF APPLICABILITY.—This section shall apply to bonds issued during the period beginning on January 1, 1998, and ending on ⟦December 31, 2005⟧ *December 31, 2006*.

SEC. 1400B. ZERO PERCENT CAPITAL GAINS RATE.

(a) * * *

(b) DC ZONE ASSET.—For purposes of this section—

(1) * * *

(2) DC ZONE BUSINESS STOCK.—

(A) IN GENERAL.—The term "DC Zone business stock" means any stock in a domestic corporation which is originally issued after December 31, 1997, if—

(i) such stock is acquired by the taxpayer, before [January 1, 2006] *January 1, 2007*, at its original issue (directly or through an underwriter) solely in exchange for cash,

* * * * * * *

(3) DC ZONE PARTNERSHIP INTEREST.—The term "DC Zone partnership interest" means any capital or profits interest in a domestic partnership which is originally issued after December 31, 1997, if—

(A) such interest is acquired by the taxpayer, before [January 1, 2006] *January 1, 2007*, from the partnership solely in exchange for cash,

* * * * * * *

(4) DC ZONE BUSINESS PROPERTY.—

(A) IN GENERAL.—The term "DC Zone business property" means tangible property if—

(i) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2) after December 31, 1997, and before [January 1, 2006] *January 1, 2007*,

* * * * * * *

(B) SPECIAL RULE FOR BUILDINGS WHICH ARE SUBSTANTIALLY IMPROVED.—

(i) IN GENERAL.—The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as met with respect to—

(I) property which is substantially improved by the taxpayer before [January 1, 2006] *January 1, 2007*, and

* * * * * * *

(e) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) * * *

(2) GAIN BEFORE 1998 OR AFTER [2010] *2011* NOT QUALIFIED.—The term "qualified capital gain" shall not include any gain attributable to periods before January 1, 1998, or after [December 31, 2010] *December 31, 2011*.

* * * * * * *

(g) SALES AND EXCHANGES OF INTERESTS IN PARTNERSHIPS AND S CORPORATIONS WHICH ARE DC ZONE BUSINESSES.—In the case of the sale or exchange of an interest in a partnership, or of stock in an S corporation, which was a DC Zone business during substantially all of the period the taxpayer held such interest or stock, the amount of qualified capital gain shall be determined without regard to—

(1) * * *

(2) any gain attributable to periods before January 1, 1998, or after ❲December 31, 2010❳ *December 31, 2011*.

*   *   *   *   *   *   *

SEC. 1400C. FIRST-TIME HOMEBUYER CREDIT FOR DISTRICT OF COLUMBIA.

(a) * * *

*   *   *   *   *   *   *

(i) APPLICATION OF SECTION.—This section shall apply to property purchased after August 4, 1997, and before ❲January 1, 2006❳ *January 1, 2007*.

*   *   *   *   *   *   *

PART II—RENEWAL COMMUNITY CAPITAL GAIN; RENEWAL COMMUNITY BUSINESS

*   *   *   *   *   *   *

SEC. 1400F. RENEWAL COMMUNITY CAPITAL GAIN.

(a) * * *

*   *   *   *   *   *   *

(d) CERTAIN RULES TO APPLY.—For purposes of this section, rules similar to the rules of paragraphs (5), (6), and (7) of subsection (b), and subsections (f) and (g), of section 1400B shall apply; except that for such purposes section 1400B(g)(2) shall be applied by substituting "January 1, 2002" for "January 1, 1998" and "December 31, 2014" for "❲December 31, 2010❳ *December 31, 2011*".

*   *   *   *   *   *   *

Subtitle K—Group Health Plan Requirements

*   *   *   *   *   *   *

CHAPTER 100—GROUP HEALTH PLAN REQUIREMENTS

*   *   *   *   *   *   *

Subchapter B—Other Requirements

*   *   *   *   *   *   *

SEC. 9812. PARITY IN THE APPLICATION OF CERTAIN LIMITS TO MENTAL HEALTH BENEFITS.

(a) * * *

*   *   *   *   *   *   *

(f) APPLICATION OF SECTION.—This section shall not apply to benefits for services furnished—

(1) * * *

*   *   *   *   *   *   *

(3) after [December 31, 2005] *December 31, 2006*.

*   *   *   *   *   *   *

SECTION 303 OF THE JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003

SEC. 303. SUNSET OF TITLE.

All provisions of, and amendments made by, this title shall not apply to taxable years beginning after [December 31, 2008] *December 31, 2010*, and the Internal Revenue Code of 1986 shall be applied and administered to such years as if such provisions and amendments had never been enacted.

VIII. DISSENTING VIEWS

Several months ago, Hurricane Katrina forced America to see poverty and its consequences every night on the evening news. For many in New Orleans, poverty was the difference between the ability to escape the disaster and being left behind to face the consequences of the Hurricane with little or no assistance from the Federal government.

The failure of the Federal government to react quickly and effectively to the Hurricane forced President Bush to respond. He made a stirring speech vowing to rebuild New Orleans regardless of the cost. His speech also expressed concern about the growing divide in this country between the rich and the poor.

Both before and after that speech, Americans have been exposed to the real plight of poverty in this country. The number of people in poverty has increased by 5.4 million under Republican policies between 2000 and 2004. The number of children alone in poverty increased by 1.5 million. The Census Bureau reported that the number of Americans in poverty increased by 1.1 million in 2004, and the poverty rate increased to 12.7%. Today a total of 37 million Americans live in poverty.

Watching the chilling footage of Hurricane Katrina brought home a reality that is all too real to poor people in America: poverty can be a death sentence. Poor children are more likely to suffer chronic health problems, lower cognitive scores, and lower school achievement. The real tragedy is that those who are left to fend for themselves in the most dire conditions become trapped in a cycle of poverty—children who experience persistent poverty are more likely to be poor as adults.

President Bush's speech and the evidence of increasing poverty gave hope that at long last the American people would see the compassionate side of President Bush's "compassionate conservative" agenda. But a decent interval has passed. President Bush and his Republican supporters in the Congress have returned to their true agenda of cutting programs protecting the most vulnerable in our society and reducing taxes on the most fortunate.

Even in light of the fact that the number of Americans in poverty has grown by millions over the last four years, Congress will soon vote on a budget bill that cuts health coverage, food assistance, and student aid to needy Americans. Other programs, including Temporary Assistance for Needy Families (TANF), the Child Care and Development Block Grant, and the Social Services Block Grant will not be allowed to keep pace with inflation, so they too will decline in real terms. There is no compassion in the Republican agenda for the most vulnerable Americans.

This nation also is involved in a war in Iraq. This will be the first war in our country's history where only those in the military and the poor will be forced to sacrifice. This will be the only time when we will cut taxes for wealthy individuals during a war. The Congressional Research Service (CRS) recently estimated the total cost of military activities in Iraq, Afghanistan, and for enhanced base security since September 11, 2001. The October 3, 2005, CRS report shows a total budget authority of $311.7 billion for FY2001–FY2005, and $214.6 billion for Iraq operations alone. This country faces a costly war, yet this Republican Congress sees fit to shield the wealthy from those costs, and even reward them with increased tax cuts. The sense of shared sacrifice that has characterized our history is missing.

The fact that these are not normal times makes it very easy to oppose the Committee bill that provides tax reductions disproportionately benefitting the truly wealthy. But even in normal times, it would be very easy to oppose the Committee bill.

- The Committee bill is another in a series of reckless tax cuts that continue to leave this country facing enormous deficits. The largest unfunded responsibility faced by this country is not Social Security or Medicare, it is interest on the national debt. Increasingly, we are ceding control of our future to foreign investors who have financed our recent deficits.
- The Committee bill also demonstrates that the many budgetary gimmicks used by the Republicans to hide the cost of their tax cuts have finally come home to roost. Even the Republicans now recognize that they cannot afford all of the tax cuts that they have promised in the big print of their bills. The Committee Republicans were faced with a choice. They could extend a tax cut for investors (a tax cut which does not expire until 2009 and over 50% of which will be enjoyed by individuals with annual incomes of over $1 million) or they could avoid a tax increase (of up to $3,380) on 15 million American families next year. Even we were surprised by their choice.
- A prime example of the flawed Republican priorities concerns our military. Some of our military serving in combat in Iraq will face tax increases next year because one of the few temporary tax benefits not extended by the Committee bill is a provision that provides a larger earned income tax credit to low-income families with a mother or father serving in Iraq. During the markup, the Committee Republicans refused to extend that tax benefit, hiding behind arcane Senate Budget rules which do not even apply in the House. But the excuse of those arcane Senate rules did not prevent the Committee Republicans from adopting other tax benefits to benefit a variety of other interests.

EXPLODING DEFICIT

When President Bush took office in January 2001, the projected ten-year (FY2002–11) budget *surplus* was $5.6 trillion. Under Bush Administration policies, the budget outlook has deteriorated into a *deficit* of $3.5 trillion (over the same period)—a swing of $9.1 trillion.

The Congressional Budget Office (CBO) now estimates that the ten-year total budget deficit for FY2006–15 will reach more than $2.1 trillion, and the on-budget deficit (excluding the temporary sound security surpluses) nearly $4.6 trillion, based on current law (the required CBO baseline assumption). In addition, CBO estimates that the cost of making the tax cuts permanent would raise the ten-year deficit by nearly $1.9 trillion, to $4.0 trillion. If the higher exemption level in the AMT were also extended, with no offsetting provision, the ten-year deficit would increase by $775 billion more.

The current federal debt limit (a gross debt measure) is $8.184 trillion, and we are now less than $200 billion away from that limit. Since President Bush took office, the limit has been raised by more than $2.2 trillion. To make room for the President's current budget proposals, the Republican fiscal plan will raise the debt limit by another $781 billion—for a total increase in the debt of around $3 trillion.

Republicans repeatedly claim that the problem has been "runaway domestic spending," but the fact is that most of the deterioration in the fiscal outlook has been due to the drop in revenues. Revenues fell from nearly 20.9 percent of GDP in 2000 to just 16.3 percent in 2004, while outlays increased from 18.4 percent to 19.8 percent (the bulk of which went to the costs of the war). Revenues had not been that low in 45 years.

One consequence of this out of control, borrow-and-spend budgeting is the rapid increase in the amount of U.S. Treasury securities sold to foreign interests. Currently, foreign investors own more than $2 trillion in U.S. bonds and notes. Furthermore, more than half of that amount is owned by foreign central banks.

Since 2001, foreign investors purchased close to 90% of the new debt held by the public. Clearly, foreign ownership of our publicly held debt has created a financial vulnerability with national security implications. A country cannot be the world's leading economic and military power if its government financing is dependent on funds from foreign countries, many of which oppose our policies.

Instead of ignoring this threat to our nation, we need decisive action, and that will not be possible without a bipartisan agreement. Therefore, the President and Congressional leaders need to stop discounting this crisis and come together to confront our fiscal problems. We owe it to the American people to act responsibly by sitting-down together and devising a serious plan to keep America from going even deeper into debt.

TAX INCREASE ON 15 MILLION FAMILIES

In recent years, the Congress has used a variety of budget gimmicks to hide the true cost of the tax reductions that are boldly promised in the big print of their tax cut legislation. Those gimmicks include phase-ins, sunsets, temporary provisions, and the alternative minimum tax (AMT).

The AMT is probably the largest and the most consequential of those budget gimmicks. According to the Joint Committee on Taxation, the 2001 and 2003 tax cuts almost tripled the size of the AMT problem, from $400 billion over 10 years under prior law to $1.139 trillion today. Again, according to the Joint Committee on Taxation, the individual AMT will deny $739 billion of tax relief over the next ten years that was promised in the big print of the 2001 and 2003 tax cuts.

The individual AMT also dramatically changed the distribution of the 2001 and 2003 tax cuts. The AMT will limit the tax cuts provided to middle-income and moderately wealthy taxpayers while taking away relatively little of the tax cuts given to the very wealthy. In 2010, the AMT will take back only 9.2 percent of the promised tax cuts from individuals making more than $1 million per year. In contrast, individuals with incomes between $75,000 and $100,000 will lose 21 percent of the tax cuts, and individuals between $100,000 and $200,000 will lose 47 percent of the tax cuts.

Even without the AMT, the recent tax cuts would disproportionately benefit upper income taxpayers. With the AMT, they will disproportionately benefit the super wealthy, those making more than $1 million per year.

Next year, under the Committee bill, approximately 19 million families will be affected by the minimum tax, an increase from approximately 3.5 million this year. As a result, over 15 million families will face a tax increase next year compared to their liability in 2005. The size of the tax increase could be as much as $3,380.

Even as millions of Americans face a tax increase due to a provision of law that expires in little more than six weeks, the Committee's bill instead concentrates on two provisions that do not expire until 2009.

President Bush and his Republican Congressional allies vow to make the Bush tax cuts permanent. But they ignore the fact that the AMT will repeal all or a portion of the Bush tax cuts for approximately 19 million families next year because of the choices made by the Committee bill.

There was another alternative. The Democratic substitute would have totally eliminated the AMT for all families with incomes under $200,000. If that substitute had been adopted, the number of AMT taxpayers would drop next year from 19 million under the Committee bill to approximately 3 million. The substitute would have eliminated the Republican tax increase on 15 million American families.

CONCLUSION

The Committee bill ignores the reality facing millions of Americans, and instead chooses to focus on the nation's most wealthy. The struggles of those in poverty fall into the shadows of giant tax cuts skewed to the richest of the rich Americans. The Republicans on this Committee have failed in their job to legislate responsibly in the interest of all Americans, especially those who have been left behind to fend for themselves by conservative Republican policies that offer no compassion.

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