RSC
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Tax Relief Extension Reconciliation Act Conference Report (H.R. 4297)

Tax Reconciliation Summary

Order of Business: The conference report is scheduled to be considered on Wednesday, May 10th, subject to a closed rule (H.Res. 805).

Savings to Taxpayers: According to the Joint Committee on Taxation (JCT), the conference report would save taxpayers a net $10.76 billion in FY2006, **$69.96 billion over five years**, and $69.08 billion over ten years. The House-passed version of H.R. 4297 would have saved taxpayers a net $5.8 billion in FY2006, $56.1 billion over five years, and $80.5 billion over ten years. Note: all of these figures above are static scores and do not account for the stimulative effects that some tax cuts and tax-cut extensions have on the economy.

Major Inclusions in Conference Report of Items Not in House-Passed Bill:
(see details in summary section below)

- One-year AMT patch
- Increased allowable rollovers to Roth IRAs
- Removal of certain FSC-ETI grandfathering rules
- Increased taxation of Americans living abroad
- Increased taxation of minors' income
- Down payments on offers-in-compromise

Major Exclusions from Conference Report of Items in House-Passed Bill:
(see details in summary section below)

- State and local sales tax deduction extension
- Technology research and experimentation tax credit extension
- Saver's credit extension
- Work Opportunity Tax Credit (WOTC) extension
- Reduction in depreciation timeframe for leasehold improvements
- Reduction in depreciation timeframe for restaurant improvements
- Higher education expenses deduction extension
- Brownfield expensing extension

Many of the provisions that were in the House-passed bill but are not contained in the conference report (such as the extension of the state/local sales tax deduction) are likely to be added to the conference report for the pension bill (H.R. 2830) or to move in a separate extenders package.

To read the RSC Legislative Bulletin on the original House version of H.R. 4297, visit this webpage: http://www.house.gov/pence/rsc/doc/LB_120805_taxreconcil.pdf

Special Note: The charitable associations provisions and the codification of the economic substance doctrine in the Senate-passed tax reconciliation bill, about which many RSC Members and conservative entities were concerned, are **NOT** in the conference report.

Background: Under the budget resolution (H.Con.Res. 95), the House Ways and Means Committee was instructed to report legislation reducing revenues by up to $70 billion over five years (static score not accounting for any economic stimulative effects of certain tax cuts). This instruction serves to limit the total amount of tax relief that can receive reconciliation protection through Congress (meaning a mere simple majority--51 votes--are needed to pass the bill in the Senate, as opposed to a higher procedural hurdle--60 votes).

The House passed its version of tax reconciliation (H.R. 4297) on December 8, 2005, by a vote of 234-197: http://clerk.house.gov/evs/2005/roll621.xml. The Senate amended the bill and passed it by a vote of 66-31: http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=109&session=2&vote=00010.

Committee Action: On November 15, 2005, the Ways & Means Committee marked up and ordered H.R. 4297 reported to the full House by a vote of 24-15.

Overview of the Tax Relief Extension Reconciliation Act CONFERENCE REPORT:

In Millions

	Static Revenue Increases and Decreases--Five Years
Gross Savings to Taxpayers	**$73,046**
Extensions and Modifications	*($33,367)*
Other Provisions	*($167)*
Individual AMT Provisions	*($33,872)*
Corporate Estimated Tax Provisions	*($5,640)*
Revenue Raisers	**$3,086**
Net Savings to Taxpayers	**$69,960**

<u>Overview of the HOUSE-PASSED Tax Relief Extension Reconciliation Act</u>:

In Millions

	Static Revenue Increases and Decreases--Five Years
Gross Savings to Taxpayers	**$56,082**
One-Year Extensions	*($19,135)*
Two-Year Extensions	*($36,815)*
Other Provisions	*($132)*
Revenue Raisers	**$0**
Net Savings to Taxpayers	**$56,082**

<u>Summary by Title of the Tax Relief Extension Reconciliation Act</u>:

<u>Title I: Extension and Modification of Certain Provisions</u>
Net savings to taxpayers over five years: $33.37 billion

- **<u>Section 179 Expensing</u>**. Extends the sunset date for two years (from 2008 to 2010) for the expanded Section 179 expensing provisions in current law. Presently, small businesses may expense (i.e., deduct in the first year) up to $100,000 of certain asset investments, phasing out dollar-for-dollar to the extent the business' annual investments exceed $400,000. Without this provision, the expensing limit will decline to $25,000 and the phase-out threshold will decline to $200,000 after the end of 2007. **Net savings to taxpayers over five years: $7.27 billion**

- **<u>Capital Gains and Dividends</u>**. Maintains the capital gains and dividend income tax rate at 15% (0% for taxpayers in the 10- and 15-% marginal income tax brackets during 2008). Without this provision, the capital gains rate will increase to a maximum of 20% and the dividend income rate will increase to a maximum of 35%. The provision extends the reduced rates through 2010. *[Set to expire after December 31, 2008; proposal would extend this expiration to December 31, 2010.]* **Net savings to taxpayers over five years: $20.55 billion**

- **<u>Subpart F Active Financing Exception</u>**. Exempts companies in the active conduct of financing (including banks and insurance companies) from laws requiring the immediate taxation of foreign subsidiaries of U.S. companies, even if their income has not been brought back to the United States. The bill also expands the exception to include cross-border payments of dividends, rents, and royalties that are funded with active income that has not been repatriated. Extends these current-law provisions for two years (through the end of tax-year 2008). **Net savings to taxpayers over five years: $5.54 billion**

Title II: Other Provisions
Net savings to taxpayers over five years: $167 million

- **Environmental Cleanup Funds**. Exempts environment cleanup settlement funds, escrow accounts, and similar funds from federal taxation, if certain standards and requirements are met (as detailed in the legislation). **Net savings to taxpayers over five years: $44 million**

- **Active Trade or Business Test**. Modifies the definition of "active conduct of a trade or business" (as it relates to certain corporate distributions) to treat a corporation and the corporation's separate affiliated group (i.e. holding company) as one corporation. The Ways & Means Committee asserts that this provision has the effect of, "allow[ing] corporations to avoid costly and inefficient internal restructurings prior to engaging in certain corporate distributions to their shareholders." **Net savings to taxpayers over five years: $33 million**

- **Veterans' Mortgages**. Makes all veterans (not just ones who served prior to 1977, as in current law) eligible to participate in state home mortgage programs funded by Qualified Veterans' Mortgage Bonds (which are aimed at financing affordable mortgages for veterans). Veterans would have to apply for financing under such a program within 25 years of the last day of active military service. The bill also alters the caps on bond issues so that the current-law formula is replaced with phased-in hard-dollar limits for participating states and removes the cap altogether in 2011 and thereafter. **Net savings to taxpayers over five years: $7 million**

- **Self-Created Musical Works**. Treats the sale or exchange of self-created musical works as capital gains (rather than as regular income, as under current law). **Net savings to taxpayers over five years: $14 million**

- **Tonnage Tax**. Reduces from 10,000 to 6,000 the minimum deadweight tons required for U.S.-flagged vessels (that participate in commercial foreign trade) to opt into the alternative tonnage tax regime. The Ways & Means Committee reports that this regime is generally more favorable for vessels (i.e. offers them lower tax assessments). This tonnage revision would expire at the end of 2010. **Net savings to taxpayers over five years: $17 million**

- **Permanent University Fund**. Codifies and makes more favorable the IRS regulations that govern the tax treatment of tax-exempt bonds issued by the Permanent University Fund (which is used to finance the activities of certain state universities). **Net savings to taxpayers over five years: $4 million**

- **Amortization for Songwriters**. Allows taxpayers to elect to amortize the costs of creating or acquiring a musical composition over five years (in lieu of the "income forecast" method). **Net *loss* to taxpayers over five years: $6 million**

- **<u>Industrial Development Bonds</u>**. Accelerates (from September 30, 2009 to December 31, 2006) the date after which the increased $20 million capital expenditure limitation would sunset for industrial development bonds (tax-exempt state and local bonds used to finance private business manufacturing facilities or the acquisition of land and equipment by certain farmers). **Net savings to taxpayers over five years: $44 million**

- **<u>Loans to Qualified Continuing Care Facilities</u>**. Reforms the tax treatment of loans to continuing-care facilities through the end of 2010. **Net savings to taxpayers over five years: $10 million**

<u>Title III: Alternative Minimum Tax Relief</u>
Net savings to taxpayers over five years: $33.87 billion

- **<u>AMT Patch</u>**. Increases for 2006 the exemption for the Alternative Minimum Tax (AMT) from $40,250 (in 2005) to $42,500 for single filers and from $58,000 (in 2005) to $62,550 for married couples filing jointly. Without this provision, the AMT exemption would decrease from $40,250 to $33,750 for single filers and from $58,000 to $45,000 for married couples filing jointly. (Technically, this decrease has already happened in 2006, but since taxpayers do not file their 2006 tax returns until 2007, no taxpayer has felt the impact of the decrease yet.) **Net savings to taxpayers over five years: $31.05 billion**

- **<u>AMT Personal Credits</u>**. Allows non-refundable, personal tax credits (like the dependent care credit, certain home mortgage interest credit, etc.) to be claimed without forcing an individual into the Alternative Minimum Tax (AMT), essentially holding him harmless. **Net savings to taxpayers over five years: $2.83 billion**

<u>Title IV: Corporate Estimated Tax Provisions</u>
Net savings to taxpayers over five years: $5.64 billion

- **<u>Estimated Tax Payment Increases</u>**. Increases corporate estimated tax payments due July through September for corporations with more than $1 billion in assets in certain years (increases to 105% in 2006, 106.25% in 2012, and 100.75% in 2013 of the otherwise required amount). **Net savings to taxpayers over five years: $0**

- **<u>Estimated Tax Payment Delays</u>**. Delays the due date until October 1st for a portion of corporate estimated taxes (20.5% in 2010 and 27.5% in 2011) that are otherwise due on September 15th in certain years. **Net savings to taxpayers over five years: $5.64 billion (but revenue neutral over ten years)**

<u>Title V: Revenue Offset Provisions</u>
Net <u>loss</u> to taxpayers over five years: $3.09 billion

- **Applying Earnings Stripping Rules to Partners that Are C Corporations.** Codifies proposed Treasury regulations attributing partnership interest income, interest expenses, and liabilities to corporate partners for purposes of applying earning stripping rules. **Net *loss* to taxpayers over five years: $106 million**

- **Interest on Tax-Exempt Bonds.** Subjects interest paid on tax-exempt bonds to the same information reporting requirements as interest paid on taxable obligations. **Net *loss* to taxpayers over five years: $9 million**

- **Geological and Geophysical Expenditures**. Increases from two years to five years the amortization allowed for certain geological and geophysical expenditures made producers of crude oil that have at least 500,000 barrels in average daily worldwide production of crude and at least $1 billion in gross receipts in its last taxable year. **Net *loss* to taxpayers over five years: $160 million**

- **FIRPTA**. Modifies the application of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) regime to investment entities with significant interests in United States real property so that it is harder to avoid FIRPTA treatment for certain investments. **Net *loss* to taxpayers over five years: $13 million**

- **Limitation on Spin-Offs**. Denies tax-free treatment (under Section 355 of the tax code) to certain spin-off corporations where either the distributing corporation or the controlled corporation is a "disqualified investment corporation," defined as having *investment* assets (such as cash or stock) that are two-thirds or more (75% or more under a first-year transition rule) of the value of the corporation's *total* assets. **Net *loss* to taxpayers over five years: $46 million**

- **Pooled Financing Bonds**. Imposes new requirements on pooled financing bonds in order for them to be tax-exempt:
  --the issuer must "reasonably" expect that at least 30% of the net proceeds of the pooled bonds will be lent to borrowers one year after the date of issue (and 95% three years after issue);
  --the issuer must obtain written loan commitments identifying borrowers for at least 30% of the net proceeds of such issue (subject to certain exceptions);
  --the issuer must redeem outstanding bonds with proceeds that are not loaned to borrowers within the expected loan origination periods; and
  --the rule allowing an issuer of pooled financing bonds to disregard the pooled bonds for purposes of determining whether the issuer qualified for the small issuer exception rebate would be eliminated.

  Net *loss* to taxpayers over five years: $172 million

- **Down Payments on Offers-In-Compromise**. Requires that taxpayers making a lump-sum offer-in-compromise of disputed taxes owed submit to the U.S. Treasury a 20% down payment of such offer. For periodic payment offers, the taxpayer would be required to comply with his own payment schedule while the offer is being considered, otherwise the offer would be deemed withdrawn. An offer would be deemed accepted if the IRS does not make a decision with respect to the offer within two years of submission. **Net *loss* to taxpayers over five years: $715 million**

- **Taxation of Minor's Income**. Raises from 14 to 18 the age under which the unearned income (such as interest) of minors must be taxed at their parent's marginal tax rate. Makes an exception for distributions from certain qualified disability trusts. **Net *loss* to taxpayers over five years: $776 million**

- **Withholding on Certain Government Payments**. Imposes a 3% withholding requirement on payments by all levels of government and their instrumentalities (other than local governments with less than $100 million of annual expenditures) for property and services (including payments made in connection with a government voucher or certificate program, but excluding payments related to certain public benefits programs). Applies only to governmental payments made after December 31, 2010. **Net *loss* to taxpayers over five years: $0 (but nearly $7 billion over ten years)**

- **Conversion to Roth IRAs**. Allows more taxpayers to convert to Roth IRAs by removing the modified adjusted gross income limitations on rollovers from a regular IRA to a Roth IRA. Taxpayers could elect to pay tax on amounts converted in 2010 in equal installments in 2011 and 2012. **Net savings to taxpayers over five years: $447 million (but increases revenue by a net total of $6.4 billion over ten years)**

- **Repeal Certain FSC/ETI Grandfathering Rules**. Repeals the rules grandfathering certain binding contracts under the foreign sales corporation/extraterritorial income (FSC/ETI) regimes, in compliance with a recent ruling of the World Trade Organization and threats to implement punitive tariffs against the United States if not corrected. **Net *loss* to taxpayers over five years: $467 million**

- **Domestic Manufacturing Deduction Wage Limitation**. Modifies the domestic manufacturing tax deduction (which is 50% of the wages paid in a year) to include only those wages allocable to domestic production gross receipts. **Net *loss* to taxpayers over five years: $43 million**

- **Section 911 Modifications for U.S. Citizens Living Abroad**. U.S. citizens living and working abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign employer-provided housing costs. The conference report would:
  --accelerate the inflation adjustment of the current $80,000 foreign earned income exclusion cap;

--link the employer-provided housing exclusion to the foreign earned income exclusion cap and tighten the standard for determining the allowable amount of housing expenses;

--apply a "stacking rule" to ensure that these citizens living abroad are subject to the same U.S. tax rates as individuals living and working in the U.S.

Net *loss* to taxpayers over five years: $903 million

- **<u>Tax Shelter Transactions</u>**. Subjects certain private foundations and other tax-exempt entities (including 501c entities) to penalties for participating in prohibited tax shelter transactions as accommodation parties. Penalties vary based on whether the participation was knowing or unknowing. **Net *loss* to taxpayers over five years: $123 million**

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