

**Summary of Joint Committee on Taxation Report on Options to  
Improve Tax Compliance and Reform Expenditures**

**January 27, 2005**

**(Costs are over 10-year window)**

**I. TAX PROCEDURE AND ADMINISTRATION**

**A. Impose Withholding on Certain Payments Made by Government Entities.**

Proposal requires a three percent (3%) withholding on all payments for goods and services made by all branches and agencies of Federal government and all units of State and local governments, including counties and parishes (local governments with less than \$100 million in annual expenditures excluded). *Raises: \$6.4 billion*

**B. Require Partial Payments with Submission of Offers-in-Compromise.** Proposal requires taxpayer to make partial payments while his or her offer is being considered by IRS. The payments will be applied to the taxpayer's outstanding balance regardless of whether the offer is rejected as inadequate. *Raises: \$1.8 billion*

**C. Clarify Standards of Scrutiny for Certain Transactions with Characteristics of Tax Shelters.** When a court determines that use of the economic substance doctrine is appropriate to address substance over form, and any of six "applicable transaction" categories are involved, the proposal requires a conjunctive test of both economic substance and business purpose. Applicable transactions are generally abusive in nature. *Raises: \$7.8 billion*

**II. INDIVIDUAL INCOME TAX**

**A. Provide Uniform Treatment for Dependent Care Benefits (secs. 21 & 129)**

Proposal repeals the exclusion for employer-provided care making the dependent care credit the exclusive means for receiving tax benefits for dependent care expenses. *Raises: \$12.4 billion*

**B. Combine Hope and Lifetime Learning Credits and the Above-the-Line Deduction for Higher Education Expenses (secs. 25A and 222).** Proposal combines Hope and Lifetime credits and above-the-line deduction for higher education expenses into a single credit, which applies on a per-student basis and to qualified education expenses for graduate and undergraduate education without regard to enrollment status. The credit equals 25 percent of first \$10,000 of qualified expenses per student, indexed for inflation. However, otherwise allowable aggregate credit per tax return is phased out by \$50 for each \$1,000 that adjusted gross income exceeds \$70,000 (\$140,000 if married filing a joint return), indexed for inflation. The credit is allowed against the alternative minimum tax. *Revenue neutral*

**C. Repeal of Exclusion for Qualified Tuition Reductions (sec. 117(d)).** The proposal repeals the exclusion for qualified tuition reduction by including such benefits in gross income and treats the benefits as wages for employment tax purposes. These tuition reductions, however, would be eligible for any present-law tax benefits for education expenses if the requirements are satisfied. *Raises \$1.9 billion*

**D. Deny Refundable Child Credit When Section 911 Exclusion is Elected (sec. 24)**  
The proposal denies a refundable child credit to anyone claiming the section 911 foreign earned income exclusion. *Raises: \$400 million*

**E. Repeal the Deduction for Interest on Home Equity Indebtedness (sec. 163)**  
Proposal repeals the deduction for interest on home equity indebtedness. *Raises: \$22.6 billion*

**F. Limit the Exclusion for Rental Value of a Residence Rented for Fewer Than 15 Days (sec. 280A).** The proposal limits the total exclusion for the rental value of a residence rented fewer than 15 days to \$2,000. (Currently there is no dollar limit.) Deductions attributable to such rental are allowed but reduced in proportion to the ratio of excludable rental income to total rental income from the property. *Raises: \$100 million*

**G. Extend Pro-Rata Basis Allocation Requirement to All Part-Gift, Part-Sale Transactions.** The proposal extends to all part-gift, part-sale transfers the present law pro-rata basis allocation rule applicable to bargain sales to charities in which the transferee's basis in property acquired in a part-gift, part-sale transaction is (1) the cost (sales price) of the purchased portion of the property plus (2) the transferor's basis in the gift portion of the property. *Raises: \$100 million*

**H. Simplify Taxation of Minor Children (sec. 1).** The proposal modifies the "kiddie tax" provision by increasing the age of children to which the kiddie tax provisions apply from under 14 to under 18, unless the child is married or files as a head of household. It subjects the child's unearned income in excess of an exemption amount (\$2,500, indexed for inflation) to the highest individual income tax rate applicable to income of that character, rather than to the parent's marginal rate. A return must be filed for every child whose income exceeds the filing requirement. *Raises: \$1.6 billion*

### **III. EMPLOYMENT TAXES**

**A. Provide Consistent FICA Treatment of Salary Reduction Amount (sec. 3121(a))**  
Salary reduction contributions to employer-sponsored retirement plans are currently included in FICA wages. Proposal provides consistent treatment of salary reduction amounts by including in FICA wages salary reduction amounts used to provide benefits under a cafeteria plan or to provide qualified transportation fringe benefits. *Raises: \$164 billion*

**B. Conform Calculation of FICA taxes and SECA Taxes (sec. 1402(a)(12)).**

Proposal modifies the deduction from net earnings from self-employment to make SECA taxes economically equivalent to FICA taxes. *Raises: \$3.9 billion*

**C. Extend Medicare Payroll Tax to All State and Local Government Employees (sec. 3121(u)(2)).**

Proposal extends Medicare coverage on a mandatory basis to all employees of State and local governments, without regard to their dates of hire or participation in a retirement system. *Raises: \$5.4 billion*

**D. Modify FICA Tax Exception for Students (secs. 3121(b)(10) and 3306(c)(10))**

Proposal codifies the IRS regulations that clarify the scope of the present-law student exception, and amends the student exception so that it does not apply to individuals whose earnings subject to the exception exceed an annual dollar limit. *Raises: \$3.3 billion*

**E. Apply Employment Taxes to Sales Incentive Payments Made by Manufacturers (secs. 3121, 3306, and 3401).**

Sales incentives paid by manufacturers or distributors to sales people employed by a dealer are wages and are subject to all employment taxes, regardless whether an employer – employee relationship exists between the sales person and the manufacturer or distributor. The manufacturer or distributor is responsible for complying with all applicable employment tax requirements. *Raises: \$400 million*

**F. Modify Determination of Amounts Subject to Employment or Self-Employment Tax for Partners and S Corporation Shareholders (sec. 1402).**

Proposal provides that all partners are subject to rules currently applicable to general partners for determining income for self-employment tax purposes. However, if a partner does not materially participate in the trade or business of the partnership, a special rule limits net earnings from self-employment to reasonable compensation. For employment tax purposes, an S corporation is treated as a partnership and any shareholders of the S corporation are treated as general partners. *Raises: \$57.4 billion*

#### **IV. HEALTH, PENSIONS, AND EMPLOYEE BENEFITS**

**A. Conform Definition of Qualified Medical Expenses (secs. 105, 213, 220, and 223)**

Under the proposal, the definition of medical expenses for purposes of the tax treatment of reimbursements from employer-sponsored accident and health plans, HSAs, and MSAs are conformed to the definition of medical expenses that may be taken into account for purposes of the itemized deduction for medical expenses. *Raises: \$500 million*

**B. Limit Deduction for Personal Use of Company Aircraft and Other Entertainment Expenses (sec. 274(e)).**

Under the proposal, in the case of *all* individuals, not just “covered employees,” the exceptions to the general entertainment expense disallowance rule for expenses treated as compensation or includible in income apply only to the extent of the amount of expenses treated as compensation or includible in income. Therefore, no deduction is allowed relating to expenses for: (1) a nonbusiness

activity generally considered to be entertainment, amusement or recreation, or (2) a facility (e.g., an airplane) used in connection with such activity to the extent these expenses exceed the amount treated as compensation or includible in income. *Raises: \$100 million*

**C. Limit Deduction for Income Attributable to Property Transferred in Connection with the Performance of Services to Amount Included in Income by the Service Provider (sec. 83).** The proposal overrides the *Robinson* decision and reaffirms the clear language of section 83 that the amount of the deduction allowed with respect to a transfer of property in connection with the performance of services is determined by reference to the amount actually included in income by the service provider under section 83.

*Raises: \$300 million*

**D. Provide the Payments in Redemption of Stock Held by and ESOP Not Deductible as dividends (sec. 404(k)).** The proposal provides that, for purposes of determining whether an amount is deductible as a dividend under section 404(k), each ESOP participant is treated as the direct owner of any shares allocated to his or her account. *Raises: \$3.4 billion*

**E. Provide Greater Conformity for Section 403(b) and Section 401(k) Plans (secs. 402(g), 403(b), and 415(c)(3)).** The proposal conforms the contribution rules for section 401(k) and section 403(b) plans by eliminating some of the special rules applicable to section 403(b) plans. *Raises: \$800 million*

**F. Extend Early Withdrawal Tax to Eligible Deferred Compensator Plans of State and Local Governments (sec. 72(t)).** Under the proposal, the early withdrawal tax applicable to qualified retirement plans is extended to section 457 plans of state and local government. *Raises: \$1.5 billion*

**G. Modify Prohibited transactions Rules for Individual Retirement Arrangements (“IRAs”) to Reduce Tax Shelter Transactions (sec. 4975).** The proposal expands the definition of a disqualified person for purposes of the prohibited transaction rules to include all IRA owners and entities established by IRA owners. *Raises: Less than \$10 million*

**H. Repeal Pick-Up Rules for Employee Contributions to State or Local Governmental Retirement Plans (sec. 414(h)).** Under the proposal, the pick-up rules are repealed and contributions to a State or local government plan that are designated as employee contributions under the plan are treated as employee contributions for Federal tax purposes, making such contributions includible in income and in wages for FICA purposes. *Raises: \$4.8 billion*

## V. CORPORATE AND PARTNERSHIP PROVISIONS

**A. Modify Extraordinary Dividend Rules for Common Stock (sec. 1059).** The proposal reduces the threshold for extraordinary dividends on common stock from 10 percent of the adjusted basis of the stock to five percent of such adjusted basis, still allowing the taxpayer to elect to use fair market value on the day before the ex-dividend date if such fair market value is established to the satisfaction of the Secretary. *Raises: Less than \$50 million*

**B. Reduce Tax-Indifferent Shareholder's Basis in Stock by Nontaxed portion of Extraordinary Dividend (sec. 1059).** The proposal provides that for purposes of the extraordinary dividend rules, the nontaxed portion of a dividend includes the amount of a dividend received by a shareholder to the extent the shareholder is not subject to current U.S. taxation. Shareholders not subject to current U.S. taxation generally are required to reduce their basis in stock of a corporation to the extent the dividend is not subject to current U.S. taxation. The holding period rules governing the basis reduction are not the same as under current law: In general, basis reduction is required if the shareholder has not owned the stock on which an extraordinary dividend is paid for more than two years before dividend announcement date, but this holding period requirement does not apply to redemptions treated as extraordinary dividends without regard to holding period. Special rules apply where a treaty reduces U.S. tax imposed on a dividend. *Raises: \$ 200 million*

**C. Modify Active Business and Control Requirements for Section 355 Corporate Divisions (sec. 355).** To satisfy the active business test of section 355, the proposal requires as least 50 percent of the gross assets of each of the parent corporation and the distributed subsidiary to have been used in the active conduct of one or more trades or businesses. For this purpose, the active business test is applied by reference to the relevant affiliated group rather than on a single corporation basis. The same control test used for this new active business test is used to determine whether a distributed corporation was controlled by the parent immediately prior to a corporate division. *Raises: \$ 300 million*

**D. Modify Application of the Unrelated Business Income Tax to S Corporation Shareholders (sec. 512).** Under the proposal, a tax-exempt entity (other than an employee ownership plan) is a permissible shareholder of an S corporation only if it is subject to tax on its share of S corporation income, also losses from non-S corporation sources cannot offset income from S corporations. *Raises: Less than \$50 million*

**E. Modify Safe Harbor for Allocation of Nonrecourse Deductions and Exclude Nonrecourse Liabilities from Outside Basis (secs. 704 and 752).** The new safe harbor, unlike the present-law four-prong harbor, is applicable to nonrecourse deduction attributable to nonrecourse liabilities that are secured by partnership property as well as those that are unsecured. In addition, the proposal provides that nonrecourse liabilities of a partnership are excluded from a partner's outside basis. Under the proposal,

nonrecourse deductions must still, as a general rule, be allocated in accordance with the partners' interests in the partnership. *Raises: \$2.2 billion*

**F. Modify Adjustment Rules for Basis of Undistributed Partnership Property (sec. 734).** The method of making the adjustment to remaining partnership property after a distribution of property, when the adjustments are made under section 734, is changed to reflect the difference between the basis to the partnership of the distributed property and the reduction which occurs in the distributing partner's proportionate share of the adjusted basis of the partnership property. *Raises: Less than \$50 million*

**G. Treat Guaranteed payments to Partners as Payments to Nonpartners (sec. 707)** Under the proposal, all compensation for services or use of capital that is not based on the net income (or an item of net income) of the partnership is treated as arising from a transaction between a partnership and a nonpartner. Under the proposal, the income and deduction timing rule for guaranteed payments is repealed and such payments are subject to the income and deduction timing rules for nonpartner payments. *Raises: \$500 million*

## **VI. INTERNATIONAL PROVISIONS**

**A. Amend the Employer-Provided Housing Exclusion and Impose a stacking rule with Respect to Non-Excludable Income (se. 911).** The foreign earned income exclusion remains capped at \$80,000 per annum, but is indexed for inflation every year instead of only taxable years after 2007. The employer-provided housing exclusion is modified by tying it to the foreign earned income cap and applying an objective standard to the term "reasonable housing expenses." Under the proposal, the base housing amount used to calculate the employer-provided housing exclusion is set at 16 percent of the foreign earned income exclusion cap, instead of 16 percent of the GS-14, Step 1 amount. As under present law, amounts below the base housing amount would be subject to U.S. tax. For 2005, the proposed base housing amount is \$12,800 ( $=\$80,000 \times .16$ ). Under present law, a taxpayer with excludable income under section 911 is subject to tax on the taxpayer's other income, after deductions, starting in the lowest tax rate bracket. Under the proposal, the taxpayer's other income, after deductions, is stacked on top of the section 911 exclusion amounts to arrive at the appropriate tax bracket. *Raises: \$2.2 billion*

**B. Amend Rules for Determining corporate Residency (sec. 7701).** The proposal would be an overlay on present law, as amended by the American Jobs Creation Act of 2004. Under the proposal, if a company is incorporated in the United States, it is still considered a domestic corporation and does not have to look any further to determine its residence. Foreign-incorporated entities, however, would have their residence for tax purposes determined based on the location of its primary place of management and control. *Raises: \$900 million*

**C. Modify Entity Classification Rules to Reduce Opportunities for Tax Avoidance (sec. 7701).** This proposal restricts the use of "check the box" with respect to single-

member foreign business entity organized under foreign law that has only one member is involved. Such entity must be treated as a corporation. *Raises: \$1.2 billion*

**D. Adopt a Dividend Exemption System for Foreign Business Income.** Under the proposed dividend exemption system, income earned abroad by foreign subsidiaries of U.S. parent corporations would fall into one of two categories: (1) passive and other highly mobile income, which would be taxed to the U.S. parent on a current basis under subpart F; or (2) all other income i.e. active, less-mobile income not subject to subpart F which would be exempt from U.S. tax and thus could be repatriated free of any tax impediment. The deferral and repatriation tax at the heart of the present-law system would be eliminated, and the foreign tax credit system would serve a more limited function that it does under present law. *Raises: \$54.8 billion*

## VII. OTHER BUSINESS PROVISIONS

**A. Disallow Deduction for Interest on Indebtedness Allocable to Tax-Exempt Obligations (sec. 265).** The proposal extends to all corporations (other than insurance companies) the pro-rata rule applicable to financial institutions under present law. Accordingly, except in limited circumstances, the proposal repeals the tracing rule, and it repeals the two percent de minimis exception provided by IRS guidance. It retains the present-law scope of the qualified small issuer exception and retains the present-law exception for interest on installment sales to State and local governments and extends the exception to taxpayers that become subject to the pro-rate rule under this proposal. *Raises: \$700 million*

**B. Modify Recapture of Section 197 Amortization (sec. 1245).** Under the proposal, if multiple section 197 intangibles are sold (otherwise disposed of) in a single transaction or series of transactions, the seller must calculate recapture as if all of the section 197 intangibles were a single asset. *Raises: \$200 million*

**C. Modify Application of Income Forecast Method of Depreciation (sec. 167).** This proposal modifies AJCA legislation to limit depreciation deductions under the income forecast method for certain creative property when a negative basis occurs as a result of including anticipated costs from participations and residuals before they are incurred. Excess depreciation will be recovered in subsequent years. *Raises: \$100 million*

**D. Apply Luxury Automobile Limitations to Sport Utility Vehicles (sec. 280F)** Under the proposal, all vehicles subject to either the present-law luxury automobile depreciation limitation or to the present-law section 179 expensing limitation for certain sport utility vehicles are made subject to the luxury automobile limitation. *Raises: \$1.1 billion*

**E. Disallowance of Deduction for Interest on Debt Allocable to Tax-Exempt Income of Insurance Companies (secs. 265 and 832).** The proposal extends to property and casualty insurers the pro rata interest disallowance rule that applies to financial institutions under present law section 265(b). The proposal applies not only with respect to tax-exempt interest, but also with respect to the untaxed portion of dividends received

and insurance inside buildup. Thus, in lieu of the current 15-percent proration rule, a property and casualty insurer would be allowed no deduction for the portion of its interest expense that is allocable to: (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase for the taxable year in the cash value of life insurance, endowment or annuity contracts the company owns. It does not change the tax treatment of life insurers.

*Raises: \$1.2 billion*

**F. Eliminate Double Deduction of Mining Exploration and Development Costs Under the Minimum Tax (sec. 57).** The deduction for depletion under the alternative minimum tax amended by excluding from the adjusted basis of any mining property, the amount of mining exploration and development costs that may be allowed as a deduction to the taxpayer in computing AMTI in a future taxable year. *Raises: \$300 million*

## VIII. EXEMPT ORGANIZATIONS

**A. Require Five-Year Review of Exempt Status of Public Charities and Private Foundations and Annual Notice by Organizations Not Required to File Information Returns (sec. 508).** The proposal require that every five (5) years §501(c)(3) organizations (except Houses of Worship), must file with the Secretary information on whether it continues to be organized and operated exclusively for exempt purposes. This filing must be done electronically and made publicly available. Failure to file would result in loss of tax-exempt status. *Raises: Less than \$50 million*

**B. Impose Termination Tax on Conversions of Assets of Charities (sec. 501, 507, 4941, and 4958).** The proposal applies to public charities and to private foundations, and thus eliminates the present-law aggregate tax benefit limit contained in §507. In the case of private foundations, the proposed termination tax applies to voluntary or involuntary terminations, as well as to conversion liquidation transactions. The proposed termination tax also applies to a public charity if there have been either willful repeated acts or failures to act that give rise to liability for Chapter 42 taxes, which includes §§ 4955 and 4958. In order to assure that fair consideration is paid in conversion transactions, the proposal extends the §4958 excess benefit transaction tax rules (in case of public charity) or §4941 self-dealing rules (in case of a private foundation) to an acquirer of the charity's assets in a conversion or liquidation transaction, if persons who are disqualified persons of the charitable organization are in a position to exercise substantial influence over the affairs of the acquirer at the time of or after the transaction. *No Revenue Effect*

**C. Tax Involvement by Exempt Organizations in Tax-Shelter Transactions (secs. 6011 and 6707A).** The proposal requires disclosure by tax exempt entities (often accommodating parties) to the IRS of participation in a "prohibited tax shelter transaction" and disclosure of other known parties if it is a reportable transaction. Prohibited transactions include only certain reportable transactions. New penalties at both the entity level and the entity manager level are included in the proposal, and the

deductibility of contributions to the entity may be suspended for one year. Existing disclosure penalties also apply. *Raises: \$500 million*

**D. Reform Intermediate Sanctions and Extend Certain Reforms to Private Foundations (secs. 4941 and 4958).** Proposal eliminates rebuttable presumption and establishes due diligence procedures that apply to public charities and private foundations. If an initial tax is imposed on a disqualified person under the intermediate sanctions rules or on a self-dealer under the self-dealing rules, the organization is subject to an excise tax equal to 10% of the excess benefit in the case of a public charity or a social welfare organization, or 2.5% of the amount involved in the case of a private foundation. *Raises: \$200 million*

**E. Increase the Amount of Excise Taxes Imposed on Public Charities, Social Welfare Organizations, and Private Foundations (secs. 4941, 4942, 4943, 4944, 4945, and 4958).** For acts of self-dealing other than the payment of compensation by a private foundation to a disqualified person, the initial tax on the self dealer goes from 5% to 10% of the amount involved. For acts of self-dealing regarding the payment of compensation by a private foundation to a disqualified person, the initial tax on the self-dealer goes from 5% to 25% of amount involved with 15% of which is subject to abatement. It increases the initial tax on foundation managers from 2.5% to 5% of the amount involved and increases the dollar limitation on the amount of the initial and additional taxes on foundation managers per act of self-dealing from \$10,000 per act to \$20,000 per act, and doubles the dollar limitation on organization managers of public charities and social welfare organizations for participation in excess benefit transactions from \$10,000 per transaction to \$20,000 per transaction. *Raises: Less than \$50 million*

**F. Modify Charitable Deduction for Contributions of Conservation and Façade Easements (sec. 170).** The proposal eliminates the charitable contribution deduction with respect to façade and conservation easements relating to personal residence properties, substantially reduces the deduction for all other qualified conservation contributions, and imposes new standards on appraisals and appraisers regarding the valuation of such contributions. *Raises: \$1 billion*

**G. Limit Charitable Deduction for Contributions of Clothing and Household Items (sec. 170).** The proposal limits the amount that taxpayers may deduct for contributions of clothing and household items to \$500. *Raises: \$1.9 billion*

**H. Reform Rules for Charitable Contributions of Property (sec. 170).** Option One: This proposal contains various options and concepts to limit deductions on donations of property, generally to the lesser of basis or fair market value. They do not apply to publicly traded securities and certain other property already addressed in previous legislation, i.e., intellectual property and vehicles. Suggestions for enhanced appraiser accountability, limiting the deduction to the disposition amount, and eliminating deductions for property altogether are also included. *Raises: \$2.5 billion*

**I. Require Public Disclosure of Form 990-T and Related Certification**

**Requirements (secs. 6104 and 6685).** The proposal extends the present-law public inspection and disclosure requirements and penalties applicable to the Form 990 to an organization's Form 990-T. Organizations that normally have annual total gross revenues or gross assets of at least \$10 million must include with its Forms 990 and 990T filings a certification by an independent auditor or by an independent counsel. *Raises: Less than \$50 million*

**J. Expand the Base of the Tax on Private Foundation Net Investment Income.**

Proposal amends the definition of gross investment income to include income from notional principal contracts, annuities, and other substantially similar income from ordinary and routine investments. Carrybacks of losses from sales or other dispositions of property are not included. *Raises: \$200 million*

**K. Limit Tax-Exempt Status of Fraternal Beneficiary Societies that Provide Commercial-Type Insurance (sec. 501 (c)(8)).**

A fraternal beneficiary society, order, or association is exempt from tax as an organization described in section 501(c)(8) only if no substantial part of its activities consists of providing commercial-type insurance. In the case of an organization that is exempt from tax under the proposal, it is taxed under the rules relating to insurance companies rather than under the unrelated business income tax rules generally applicable to exempt organizations. *Raises: \$500 million*

**L. Established Additional Exemption Standards for Credit Counseling**

**Organizations (sec. 501).** Under the proposal, a nonprofit credit counseling agency or other nonprofit organization that provides credit counseling, debt management, and similar services, is eligible for exemption from income tax only as a charitable or educational organization under section 501(c)(4). It also provides additional requirements that must be satisfied by a credit counseling organization in order to be an organization described in section 501(c)(3) or (c)(4), and the requirements supplement, rather than replace the present law requirements. *Raises: \$100 million*

**IX. TAX-EXEMPT BOND PROVISIONS**

**A. Impose Loan and Redemption Requirements on Pooled Financing Bonds (sec.**

**149).** The proposal imposes new requirements on pooled financing bonds as a condition of tax-exemption. These include a written loan commitment requirement to restrict "blind pools", an additional expectation requirement that at least 50 percent of the net proceeds will be lent to borrowers one year after the date of issue, and the redemption of outstanding bonds with proceeds that are not loaned within the expected origination period. Finally, issuers are no longer allowed to disregard the pooled bonds in order to determine if they qualify for the small issuer exception to rebate. *Raises: \$500 million*

**B. Amend Information Reporting Requirements to Include Interest on Tax-Exempt Bonds (sec. 6049).** Option 1: Issuers of tax-exempt bonds are required to file

information returns identifying the amount of interest payments in a calendar year and the name, address, and TIN of the person to whom the interest is paid.

Option 2: Require the production of payee information from the issuer of any tax-exempt bond upon request of the IRS.

In both proposals, a third party may be contracted to file this information and penalty provisions would be amended to apply to interest on tax-exempt bonds. *Raises: Less than \$50 million*

**C. Clarify Limitations on Indian Tribes' Use of Tax-Exempt Bond Proceeds (sec. 7871).** In this proposal section 7871 is amended to clarify that it applies whether an Indian tribal government is a conduit borrower or an issuer of tax-exempt bonds. *Raises: \$100 million*

**D. Eliminate Private Payment Test for Stadium Bonds.** The proposal eliminates the private payment test for professional sports facilities. Then, bonds issued to finance a professional sports facility are taxable private activity bonds if more than 10 percent of the proceeds of the issue (including use of bond-financed property) are to be used in the trade or business of any person other than the government unit, regardless of the amount of private security or private payments received with respect to such use. *Raises: \$700 million*

**E. Require Allocation of Volume Cap to Mortgage Credit Certificates Based on Allocation of Volume Cap to Mortgage Bonds (secs. 25 and 143).** The proposal requires State and local issuing authorities to dedicate at least one dollar of volume cap to MCCs for every four dollars allocated to qualified mortgage bonds. Present law rates still would apply in the exchange of bond authority for MCC authority. The proposal also would raise the dollar limitation on the maximum annual credit that may be claimed with the MCC rate is greater than 20 percent from \$2,000 to \$3,000, making the MCC more usable for homebuyers. *Raises: \$100 million*

**F. Eliminate Advance Refunding of Governmental Bonds and 501(c)(3) Bonds (sec. 149(d)).** The proposal eliminates advance refunding of governmental bonds and 501(c)(3) bonds. *Raises: \$10.5 billion*

## **X. EXCISE TAXES**

### **A. Modify the Federal Excise Tax on Communications Services (sec. 4251-4254)**

Option 1: Under this option the communications excise tax is imposed on all voice telephone services regardless of whether charges are based on distance, time, or any other criteria. Definitions would be modified in order to remove any distinction between the calculation of taxes on local and long distance telephone services, as well as to clarify that the tax also applies to landline and wireless (including satellite) services.

Option 2: This option incorporates the tax changes of Option 1 and would further make all voice communications service taxable regardless of their technical form, regardless if it does not provide access to the public switched telephone network.

In general, a service component is taxable if the primary purpose of the service component is the transmission of real-time voice communications. Certain service components are expressly classified as taxable communications services: enhanced voice service features as well as other ancillary services taxable under present law. Provision of a “regular” phone line or circuit is taxable only when it can be used for real-time voice communications. Provision of broadband or dial-up Internet service is not taxable when it is not connected to the public switched telephone network.

The general billing and bundling rules remain the same, however, a nontaxable service component must be separately stated on a customer’s bill. Option 2 modifies certain present-law exemptions regarding the press, common carriers, radio broadcasting and networks, separately itemized service components between communications providers, and public coin-operated services.

The private communication services exclusion is significantly modified. Option 2 the exclusion continues to apply as under present law, but is geographically limited to (a) a Core Based Statistical Area, or (b) within one building or between buildings on a contiguous plot of land. Rules similar to Mobile Communications Sourcing Act are applicable to cross-border services.

Option 3: This option incorporates the tax changes under Options 2 and 1 and further changes to the law. Communications excise tax base is expanded to include all data communications services to end-users. In general, a service component is classified as a communications service if the primary purpose of the service component is the transmission of communications, as contrasted with the content or information capabilities via communications. The billing and bundling rules are similar to Option 2. However, unlike Option 2, communications capacity is taxable whether provided as a service, lease, or sale.

*Modifying the definitions of toll and local telephone services raises: \$100 million*

*Modernization of the excise tax on voice communications services raises: \$2 billion*

*Expansion of the tax base to all voice and data communications raises: \$11.2 billion*

**B. Equalize Alcohol Excise Taxes (sec. 5001, 5041, 5051).** The proposal imposes a uniform tax based on the alcohol content contained in the product. The tax rate is \$8.40 per proof gallon, estimated to produce a revenue neutral effect compared to present law. Section 5010 is eliminated since the rate would not be based on the source of the alcohol. As under present law, domestic wineries having aggregate annual production not exceeding 250,000 gallons are entitled to a tax credit equal to 90 cents per gallon on the first 100,000 gallons of wine removed in a calendar year. Similar to present law, domestic brewers that produce less than two million barrels of beer during the calendar year, the proposal imposes a reduced rate of tax on the first 60,000 barrels of beer removed each year. *Revenue Neutral*

**C. Subject International Flights with Wholly Domestic Segments to the Segments Tax (secs. 4261 and 4262).** The proposal imposes the segment tax on the domestic segments of an international flight. Transportation to a point outside the U.S. would not be subject to the segment tax from the last port or station in the U.S. *Raises: \$500 million*

**D. Modify the Federal Excise Tax on Sport Fishing Equipment (sec. 4161 and 4162)**

Under the proposal, the excise tax on sport fishing equipment is imposed only on fishing rods, poles, and reels. As under present law, parts or accessories that are sold on or in connection with taxable articles are also taxable. To maintain the current level of revenue generated by the tax, the rate of tax imposed on taxable articles is adjusted to 21 percent. *Negligible Revenue Effect*

**XI. ESTATE AND GIFT TAXATION**

**A. Limit Perpetual Dynasty Trusts.** The proposal prohibits the allocation of the generation skipping tax exemption to a “perpetual dynasty trust,” except to the extent that the trust provides for distributions to beneficiaries in the generations of the transferor’s children or grandchildren. Under the proposal, the generation-skipping tax exemption effectively is limited to an exemption of a skip of one generation. *Raises: \$300 million*

**B. Determine Certain Valuation Discounts More Accurately for Federal Estate and Gift Tax Purposes (secs. 2031, 2512, and 2624).** The proposal provides rules for determining the value of property for Federal transfer tax purposes, limiting the availability of minority and marketability discounts. *Raises: \$3.6 billion*

**C. Curtail the Use of Lapsing Trust Powers to Inflate the Gift tax Annual Exclusion Amount (sec. 2503).** The proposal sets forth three options that the Congress may wish to consider for improving the tax treatment of Crummey powers. *Option 1* proposes that a holder of a Crummey power is not treated as a donee with respect to an amount transferred into trust unless such holder is also a direct, noncontingent beneficiary of a trust. *Option 2* proposes that powers to demand the distribution of trust property are taken into account only if they cannot lapse during the holder’s lifetime for purposes of determining the applicability of the annual exclusion. *Option 3* proposes that that powers to demand the distribution of trust property are taken into account only if: (1) there is no arrangement or understanding to the effect that the powers will not be exercised; and (2) there exists at the time of the creation of such powers a meaningful possibility that they will be exercised for purposes of determining the applicability of the annual exclusion. *Option 1 raises: \$200 million. Option 2 raises: \$700 million. Option 3 raises: \$200 million*

**D. Provide Reporting for a consistent Basis Between the Estate Tax Valuation and the Basis in the Hands of the Heir (sec. 1014).** The proposal requires that for any property acquired as a bequest from an estate which has a Federal estate tax liability, the executor is required to provide the heir and the IRS with a statement of the value of the asset reported for estate tax purposes. The value so reported is binding on the heir as his or her basis for the purpose of computing future gain or loss as provided under present law. *Raises: Less than \$50 million*

**E. Modify Transfer Tax Provisions Applicable to Section 529 Qualified Tuition Accounts (sec. 529).** The proposal modifies the special transfer tax (gift, GST, and estate

tax) provisions of present-law section 529, and generally subjects qualified tuition accounts to otherwise applicable transfer tax provisions. In general, a contribution to a qualified tuition account is not treated as a completed gift, and is includible in the estate of the contributor or account owner, unless the terms governing the account satisfy certain requirements. *Raises: Less than \$50 million*