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FAMILY AND BUSINESS TAX CUT CERTAINTY ACT OF 2012

August 28, 2012—Ordered to be printed

Mr. BAUCUS, from the Committee on Finance,
submitted the following

REPORT

together with

DISSENTING VIEWS

[To accompany S. ??]

The Committee on Finance, having considered original legislation to amend the Internal Revenue Code of 1986 to provide for the extension of certain expiring provisions, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

CONTENTS

I. LEGISLATIVE BACKGROUND

The Senate Committee on Finance marked up original legislation (the "Family and Business Tax Cut Certainty Act of 2012") on August 2, 2012, and, with a majority and quorum present, ordered the bill favorably reported, with amendments on that date. This report describes the provisions of the bill.

II. EXPLANATION OF PROVISIONS

TITLE I − INDIVIDUAL TAX PROVISIONS

A. Alternative Minimum Tax Relief

1. Alternative minimum tax relief for individuals (secs. 101 and 102 of the bill and secs. 26 and 55 of the Code)

Present Law

Present law imposes an alternative minimum tax ("AMT") on individuals. The AMT 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 amounts are: (1) $74,450 for taxable years beginning in 2011 and $45,000 in taxable years beginning thereafter in the case of married individuals filing a joint return and surviving spouses; (2) $48,450 for taxable years beginning in 2011 and $33,750 in taxable years beginning thereafter in the case of other unmarried individuals; (3) $37,225 for taxable years beginning in 2011 $22,500 in taxable years thereafter in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits. These credits include the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child 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, the credit for alternative motor vehicles, the credit for alternative fuel vehicle refueling property, the credit for new qualified plug-in electric drive motor vehicles, and carryforwards of the D.C. first-time homebuyer credit.

For taxable years beginning before 2012, 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 2011, the dependent care credit, the credit for the elderly and disabled, the adoption credit (other than for taxable years beginning in 2012), the child credit (other than for taxable years beginning in 2012), the credit for interest on certain home mortgages, the Hope Scholarship credit (other than for taxable years beginning in 2012),

the Lifetime Learning credit, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, the credit for alternative fuel vehicle refueling property, and carryforwards of the D.C. first-time homebuyer 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 other nonrefundable personal are allowed to the full extent of the individual's regular tax and alternative minimum tax.

Reasons for Change

The Committee is concerned about the projected increase in the number of individuals who will be affected by the individual alternative minimum tax and the projected increase in tax liability for those who are affected by the tax. The provision will reduce the number of individuals who would otherwise be affected by the alternative minimum tax and will reduce the tax liability of the families that continue to be affected by the alternative minimum tax.

Explanation of Provision

The provision provides that the individual AMT exemption amount for taxable years beginning in 2012 is (1) $78,750, in the case of married individuals filing a joint return and surviving spouses; (2) $50,600 in the case of other unmarried individuals; and (3) $39,375 in the case of married individuals filing separate returns.

The provision provides that the individual AMT exemption amount for taxable years beginning in 2013 is (1) $79,850, in the case of married individuals filing a joint return and surviving spouses; (2) $51,150 in the case of other unmarried individuals; and (3) $39,975 in the case of married individuals filing separate returns.

The provision allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits for taxable years beginning in 2012 and 2013.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

B. Other Individual Tax Provisions

1. Deduction for certain expenses of elementary and secondary school teachers (sec. 111 of the bill and sec. 62(a)(2)(D) of the Code)

Present Law

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally 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. For taxable years beginning after 2012, 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 a threshold amount. In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Certain expenses of eligible educators are allowed as an above-the-line deduction. Specifically, for taxable years beginning prior to January 1, 2012, 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.[1] 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), 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 twelve teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. A school means any school that provides elementary education or secondary education (kindergarten through grade 12), as determined under State law.

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2011.

Reasons for Change

The Committee recognizes that many elementary and secondary school teachers provide substantial classroom resources at their own expense, and believe that it is appropriate to extend the present law deduction for such expenses in order to continue to partially offset the substantial costs such educators incur for the benefit of their students.

[1] Sec. 62(a)(2)(D).

Explanation of Provision

The provision extends the deduction for eligible educator expenses for two years, through December 31, 2013.

Effective Date

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2011.

2. Exclude discharges of acquisition indebtedness on principal residences from gross income (sec. 112 of the bill and sec. 108 of the Code)

Present Law

In general

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108).[2] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge (sec. 1017).

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

Qualified principal residence indebtedness

An exclusion from gross income is provided for any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B), except that the dollar limitation is $2,000,000) with respect to the

[2] A debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor (sec. 102).

taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. For these purposes, the term "principal residence" has the same meaning as under section 121 of the Code.

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of $1 million, of which $800,000 is qualified principal residence indebtedness. If the residence is sold for $700,000 and $300,000 debt is discharged, then only $100,000 of the amount discharged may be excluded from gross income under the qualified principal residence indebtedness exclusion.

The basis of the individual's principal residence is reduced by the amount excluded from income under the provision.

The qualified principal residence indebtedness exclusion does not apply to a taxpayer in a Title 11 case; instead the general exclusion rules apply. In the case of an insolvent taxpayer not in a Title 11 case, the qualified principal residence indebtedness exclusion applies unless the taxpayer elects to have the general exclusion rules apply instead.

The exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

The exclusion for qualified principal residence indebtedness is effective for discharges of indebtedness before January 1, 2013.

Reasons for Change

The Committee believes that where a lender discharges acquisition debt on a principal residence such as is the case of a short sale or when a taxpayer loses their principal residence through a foreclosure, it is inappropriate to treat discharges of indebtedness as income.

Explanation of Provision

The provision extends for one additional year (through December 31, 2013) the exclusion from gross income for discharges of qualified principal residence indebtedness.

Effective Date

The provision is effective for discharges of indebtedness on or after January 1, 2013.

3. Parity for mass transit and parking benefits (sec. 113 of the bill and sec. 132(f) of the Code)

Present Law

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income for income tax purposes and from an employee's wages for employment tax purposes.[3] Qualified transportation fringe benefits include parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. No amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits (other than a qualified bicycle commuting reimbursement). Qualified transportation fringe benefits also include a cash reimbursement by an employer to an employee for parking, transit passes, or vanpooling. In the case of transit passes, however, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item that may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

Before February 17, 2009, the amount that could be excluded as qualified transportation fringe benefits was limited to $100 per month in combined transit pass and vanpool benefits and $175 per month in qualified parking benefits. These limits are adjusted annually for inflation, using 1998 as the base year; for 2012 the limits are $125 and $240, respectively. The American Recovery and Reinvestment Act of 2009[4] provided parity in qualified transportation fringe benefits by temporarily increasing the monthly exclusion for combined employer-provided transit pass and vanpool benefits to the same level as the exclusion for employer-provided parking, effective for months beginning on or after the date of enactment (February 17, 2009) and before January 1, 2011. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010[5] extended parity in qualified transportation fringe benefits through December 31, 2011.

Effective January 1, 2012, the amount that can be excluded as qualified transportation fringe benefits is limited to $125 per month in combined transit pass and vanpool benefits and $240 per month in qualified parking benefits.

Reasons for Change

Maintaining parity in transportation benefits provides employees with an incentive to use public transportation and vanpools for their commute rather than driving to work in their personal vehicles, thus potentially easing traffic congestion and pollution.

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[3] Secs. 132(a)(5) and (f), 3121(a)(20), 3231(e)(5), 3306(b)(16) and 3401(a)(19).

[4] Pub. L. No. 111-5.

[5] Pub. L. No. 111-312.

Explanation of Provision

The provision extends parity in qualified transportation fringe benefits through December 31, 2013. Thus, for 2012, the monthly limit on the exclusion for combined transit pass and vanpool benefits is $240.

In order for the extension to be effective retroactive to January 1, 2012, expenses incurred prior to enactment by an employee for employer-provided vanpool and transit benefits may be reimbursed by employers on a tax-free basis to the extent they exceed $125 per month and are less than $240 per month. The Committee intends that the rule that an employer reimbursement is excludible only if vouchers are not available to provide the benefit shall continue to apply, except in the case of reimbursements for vanpool or transit benefits between $125 and $240 only for months beginning after December 31, 2011 and before enactment. Further, the Committee intends that reimbursements for expenses incurred for months prior to enactment may be made in addition to the provision of benefits or reimbursements of up to $240 per month for expenses incurred after enactment.

Effective Date

The provision is effective for months after December 31, 2011.

4. Mortgage insurance premiums (sec. 114 of the bill and sec. 163 of the Code)

Present Law

In general

Present law provides that qualified residence interest is deductible notwithstanding the general rule that personal interest is nondeductible (sec. 163(h)).

Acquisition indebtedness and home equity indebtedness

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is $100,000. The maximum amount of acquisition indebtedness is $1 million. Acquisition indebtedness means debt that is incurred in acquiring constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

Private mortgage insurance

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10 percent for each $1,000 by which

the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of married individual filing a separate return).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Veterans Administration, the Federal Housing Administration,[6] or the Rural Housing Administration, and private mortgage insurance (defined in section two of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Service).

The provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates for any amount paid or accrued after December 31, 2011, or properly allocable to any period after that date.

Reporting rules apply under the provision.

Reasons for Change

The Committee believes it is appropriate to extend the present-law temporary provision. The Committee understands that the purpose of the provisions permitting deduction of home mortgage interest is to encourage home ownership while limiting significant disincentives to saving. The Committee believes that it would be consistent with the purpose of the provisions permitting deduction of home mortgage interest to permit the deduction of mortgage insurance premiums. While these premiums are not in the nature of interest, the Committee notes that purchase of such insurance is often demanded by lenders in order for home buyers to obtain financing (depending on the size of the buyer's down payment). The Committee believes that permitting deductibility of premiums for this type of insurance connected with home purchases will foster home ownership. In the case of higher income taxpayers who may not purchase mortgage insurance, however, the Committee believes the incentive of deductibility becomes unnecessary, and a phase-out is appropriate. It is not intended that prepayments be currently deductible, but rather, that they be deductible only in the period to which they relate. Reporting of payments is generally necessary to administer the provision.

Explanation of Provision

The provision extends the deduction for private mortgage insurance premiums for two years (with respect to contracts entered into after December 31, 2006). Thus, the provision

[6] The Veterans Administration and the Rural Housing Administration have been succeeded by the Department of Veterans Affairs and the Rural Housing Service, respectively.

applies to amounts paid or accrued in 2012 and 2013 (and not properly allocable to any period after 2013).[7]

Effective Date

The provision is effective for amounts paid or accrued after December 31, 2011.

5. Deduction for State and local sales taxes (sec. 115 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 before 2012, 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 that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account number of dependents, modified adjusted gross income and rates of State and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. 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.

A general sales tax is a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items.[8] 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 food, clothing, medical supplies, and motor vehicles, the above rules are relaxed in two ways. First, if the tax does not apply with respect to some or all of such items, a tax that applies to other such items can still be considered a general sales tax. Second, the rate of tax applicable with respect to some or all of these items may be lower than the general rate. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess is disregarded and the general rate is treated as the rate of tax.

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[7] The provision corrects the names of the Department of Veterans Affairs and the Rural Housing Service.

[8] Sec. 164(b)(5)(B).

A compensating use tax with respect to an item is treated as a general sales tax, provided such tax is complementary 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 believes an extension of the option to deduct State and local sales taxes in lieu of deducting State and local income taxes is appropriate to continue to provide similar Federal tax treatment to residents of States that rely on sales taxes, rather than income taxes, to fund State and local governmental functions.

Explanation of Provision

The provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes is extended for two years, through 2013.

Effective Date

The provision applies to taxable years beginning after December 31, 2011.

6. Contributions of capital gain real property made for conservation purposes (sec. 116 of the bill and sec. 170 of the Code)

Present Law

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[9]

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

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

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

Capital gain property

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(A) (*e.g.*, public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (*e.g.*, private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

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

Qualified conservation contributions

Qualified conservation contributions are not subject to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property.[10] A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of

[10] Secs. 170(f)(3)(B)(iii) and 170(h).

the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

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

Temporary rules regarding contributions of capital gain real property for conservation purposes

In general

Under a temporary provision[11] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

Individuals are allowed to carry over any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years.

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carry over the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and ranchers

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the above example, if the individual is a qualified farmer or rancher, in addition to the $50 deduction for non-conservation contributions, an additional $50 for the qualified conservation contribution is allowed and $30 may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.

[11] Sec. 170(b)(1)(E).

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[12]

As an additional condition of eligibility for the 100 percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.)

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

Termination

The temporary rules regarding contributions of capital gain real property for conservation purposes do not apply to contributions made in taxable years beginning after December 31, 2011.[13]

Reasons for Change

The Committee believes that the special rule that provides an increased incentive to make charitable contributions of partial interests in real property for conservation purposes is an important way of encouraging conservation and preservation, and should be extended for two additional years.

Explanation of Provision

The provision extends the temporary rules regarding contributions of capital gain real property for conservation purposes for two years for contributions made in taxable years beginning before January 1, 2014.

Effective Date

The provision is effective for contributions made in taxable years beginning after December 31, 2011.

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[12] Sec. 170(b)(2)(B).

[13] Secs. 170(b)(1)(E)(vi) and 170(b)(2)(B)(iii).

7. Deduction for qualified tuition and related expenses (sec. 117 of the bill and sec. 222 of the Code)

Present Law

An individual is allowed a deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[14] The deduction is allowed in computing adjusted gross income. The term qualified tuition and related expenses is defined in the same manner as for the Hope and Lifetime Learning credits, and includes 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.[15] The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period 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.

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, 2011.

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,[16] and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings account.[17] 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 the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

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[14] Sec. 222.

[15] The deduction generally is not available for expenses with respect to a course or education involving sports, games, or hobbies, and is not available for student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

[16] Secs. 222(d)(1) and 25A(g)(2).

[17] Sec. 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.

Reasons for Change

The Committee observes that the cost of a college education continues to rise, and thus believes that the extension of the qualified tuition deduction is appropriate to mitigate the impact of rising tuition costs on students and their families. The Committee further believes that the tuition deduction provides an important financial incentive for individuals to pursue higher education.

Explanation of Provision

The provision extends the qualified tuition deduction for two years, through 2013.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

8. Tax-free distributions from individual retirement plans for charitable purposes (sec. 118 of the bill and sec. 408 of the Code)

Present Law

In general

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

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to the following entities: (1) a charity described in section 501(c)(3); (2) certain veterans' organizations, fraternal societies, and cemetery companies;[18] and (3) a Federal, State, or local governmental entity, but only if the contribution is made for exclusively public purposes.[19] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[20]

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

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

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

A taxpayer who takes the standard deduction (*i.e.*, who does not itemize deductions) may not take a separate deduction for charitable contributions.[21]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service provided) to the taxpayer in consideration for the contribution.[22] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[23]

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

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

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (*e.g.*, a remainder) while also either retaining an interest in that property (*e.g.*, an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[24] Exceptions to this

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[21] Sec. 170(a).

[22] Sec. 170(f)(8). For any contribution of a cash, check, or other monetary gift, no deduction is allowed unless the donor maintains as a record of such contribution a bank record or written communication from the donee charity showing the name of the donee organization, the date of the contribution, and the amount of the contribution. Sec. 170(f)(17).

[23] Sec. 6115.

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

general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[25] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Certain individuals also may make nondeductible contributions to a Roth IRA (deductible contributions cannot be made to Roth IRAs). Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59-½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by April 1 of the calendar year following the year in which the IRA owner attains age 70-½.[26]

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

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[27] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

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

[26] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

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

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[28] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

Qualified charitable distributions

For taxable years beginning before January 1, 2012, otherwise taxable IRA distributions from a traditional or Roth IRA are excluded from gross income to the extent they are qualified charitable distributions.[29] The exclusion may not exceed $100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. A qualified charitable distribution is taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA as a result of qualified charitable distributions being made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (other than an organization described in section 509(a)(3) or a donor advised fund (as defined in section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70-½ and only to the extent the distribution would be includible in gross income (without regard to this provision).

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

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

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[28] Sec. 3405.

[29] Sec. 408(d)(8). The exclusion does not apply to distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under section 170.

The exclusion for qualified charitable distributions applies to distributions made in taxable years beginning after December 31, 2005. Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2011.

Reasons for Change

The Committee believes that facilitating charitable contributions from IRAs will increase giving to charitable organizations. Therefore, the Committee believes that the exclusion for qualified charitable distributions should be extended for two years.

Explanation of Provision

The provision extends the exclusion for qualified charitable distributions to distributions made in taxable years beginning after December 31, 2011, and before January 1, 2014.

Effective Date

The provision is effective for distributions made in taxable years beginning after December 31, 2011.

C. Tax Administration

1. Improve and make permanent the provision authorizing the Internal Revenue Service to disclose certain return and return information to certain prison officials (sec. 121 of the bill and sec. 6103 of the Code)

Present Law

Section 6103 provides that returns and return information are confidential and may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in the Code.[30] A "return" is any tax or information return, declaration of estimated tax, or claim for refund required by, or permitted under, the Code, that is filed with the Secretary by, on behalf of, or with respect to any person.[31] "Return" also includes any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

The definition of "return information" is very broad and includes any information gathered by the IRS with respect to a person's liability or possible liability under the Code.[32]

However, data in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer is not "return information" for section 6103 purposes.

Section 6103 contains a number of exceptions to the general rule of confidentiality, which permit disclosure in specifically identified circumstances when certain conditions are satisfied.[33] For example, one exception permits disclosure to officers and employees of the

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[30] Sec. 6103(a).

[31] Sec. 6103(b)(1).

[32] Sec. 6103(b)(2). Return information is:

- a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense,
- any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110,
- any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and
- any closing agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement.

[33] Sec. 6103(c) - (o). Such exceptions include disclosures by consent of the taxpayer, disclosures to State tax officials, disclosures to the taxpayer and persons having a material interest, disclosures to Committees of

Federal Bureau of Prisons and State prisons of return information with respect to prisoners whom the Secretary has determined may have filed or facilitated the filing of false or fraudulent tax returns. The Secretary may disclose only such information as is necessary to permit effective tax administration with respect to prisoners. The disclosure authority expired December 31, 2011.

Reasons for Change

The Committee believes that sharing information with prison officials will allow the prison officials to take appropriate disciplinary and administrative action to deter prisoners from filing false Federal tax returns. As many State prisons are run on a contract basis, and the IRS has identified a number of these prisons as sources of false returns, the Committee believes that equal disclosure authority should be afforded to such prison officials to address the matter. Permitting the disclosure of information directly to the officers and employees responsible for disciplining prisoners could improve efficiency. In addition, providing prison officials with a full copy of the false return, showing the prisoner's signature, is more likely to satisfy the burden of proof that a prisoner filed the false return.

Explanation of Provision

The provision makes permanent the authority of the IRS to disclose tax-related misconduct to the Federal Bureau of Prisons and State prison officials. In addition, the provision (1) authorizes the disclosure of actual returns (not just return information), (2) allows the disclosure to be made directly to officers and employees of the prison agency rather than through the head of such agency, (3) allows redisclosure of return information to contractors that operate prisons, and (4) clarifies the authority for the disclosure to, and use by, legal representatives in proceedings.

Effective Date

The provision is effective for disclosures made on or after the date of enactment.

2. Refunds disregarded in the administration of Federal programs and Federally assisted programs (sec. 122 of the bill and sec. 6409 of the Code)

Present Law

Any tax refund (or advance payment with respect to a refundable credit) made to any individual in calendar year 2010, 2011, or 2012 is not taken into account as a resource for a period of 12 months from receipt for purposes of determining the eligibility of such individual (or any other individual) for benefits or assistance (or the amount or extent of benefits or

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Congress, disclosures to the President, disclosures to Federal employees for tax administration purposes, disclosures to Federal employees for nontax criminal law enforcement purposes and to the Government Accountability Office, disclosures for statistical purposes, disclosures for miscellaneous tax administration purposes, disclosures for purposes other than tax administration, disclosures of taxpayer identity information, disclosures to tax administration contractors and disclosures with respect to wagering excise taxes.

assistance) under any Federal program or under any State or local program financed in whole or in part with Federal funds.

Reasons for Change

The Committee believes that it continues to be important to provide an explicit uniform rule regarding the treatment of tax refunds for purposes of determining eligibility for benefits under Federal programs (or State or local programs financed with Federal funds).

Explanation of Provision

The provision extends the present law for any tax refund (or advance payment with respect to a refundable credit) made to any individual in calendar year 2013.

Effective Date

The provision is effective for amounts received after December 31, 2012.

TITLE II − BUSINESS TAX EXTENDERS

1. Research credit (sec. 201 of the bill and sec. 41 of the Code)

Present Law

General rule

For general research expenditures, 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.[34] Thus, the research credit generally is available with respect to incremental increases in qualified research. An alternative simplified research credit (with a 14 percent rate and a different base amount) may be claimed in lieu of this credit.

A 20-percent research credit is also available with respect 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.[35]

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium. This separate credit computation is commonly referred to as the energy research credit. Unlike the other research credits, 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 not available for amounts paid or incurred after December 31, 2011.[36]

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). Special rules apply to all other

[34] Sec. 41.

[35] Sec. 41(e).

[36] Sec. 41(h).

taxpayers (so called start-up firms).[37] In computing the credit, a taxpayer's base amount cannot 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 or all members of a group of businesses under common control are treated as a single taxpayer.[38] The credit allowable to each member is its proportionate share of the qualified research expenses, basic research payments, and energy research payments giving rise to the credit.

Under regulations prescribed by the Secretary, special rules apply for computing the research credit when a major portion of a trade or business (or unit thereof) changes hands. Under these rules, qualified research expenses and gross receipts arising in taxable years prior to the change of ownership of a trade or business are treated as transferred to the acquiring taxpayer with the trade or business that gave rise to those expenses and receipts for purposes of recomputing the acquiring taxpayer's fixed-base percentage.[39] Qualified research expenses incurred during the taxable year including or ending with a change of ownership are treated as transferred to the acquiring taxpayer with the trade or business for purposes of determining the credit for the acquiring taxpayer's first taxable year including the acquisition.

Alternative simplified credit

The alternative simplified research credit is equal to 14 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 six percent if a taxpayer has no qualified research expenses in any one 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.

Eligible expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain

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[37] The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).

[38] Sec. 41(f)(1).

[39] Sec. 41(f)(3).

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).[40] 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 not only has to satisfy the requirements of present-law section 174 (described below) but also 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 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.[41] In addition, research does not qualify for the credit if: (1) conducted after the beginning of commercial production of the business component; (2) related to the adaptation of an existing business component to a particular customer's requirements; (3) related to the duplication of an existing business component from a physical examination of the component itself or certain other information; (4) related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control; (5) related to software developed primarily for internal use by the taxpayer; (6) related to social sciences, arts, or humanities; or (7) funded by any grant, contract, or otherwise by another person (or governmental entity).[42] 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.[43] However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to

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[40] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. Sec. 41(b)(3)(C).

[41] Sec. 41(d)(3).

[42] Sec. 41(d)(4).

[43] Taxpayers may elect 10-year amortization of certain research expenditures allowable as a deduction under section 174(a). Secs. 174(f)(2) and 59(e).

100 percent of the taxpayer's research tax credit determined for the taxable year.[44] Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.[45]

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. There can be cases where an individual business may not find it profitable to invest in research as much as it otherwise might because it is difficult to capture the full benefits from the research and prevent such benefits from being used by competitors. At the same time, the research may create great benefits that spill over to society at large. To encourage activities that will result in these spillover benefits to society at large, the government does act to promote research. Therefore the Committee believes it is appropriate to extend the present-law research credit.

The Committee further believes that technical changes are necessary (1) to ensure that when a business changes hands, the disposing business entity receives the research credit for expenses incurred prior to the date of a change in ownership, and (2) to simplify the allocation of research expenses among commonly controlled groups of businesses.

Explanation of Provision

The provision extends the research credit for two years (through 2013). Under the provision, the special rules for taxpayers under common control and the special rules for computing the credit when a major portion of a trade or business (or unit thereof) changes hands are modified. Qualified research expenses paid or incurred by the disposing taxpayer in a taxable year that includes or ends with a change in ownership are treated as current year qualified research expenses of the disposing taxpayer. Further, such expenses are not treated as current year qualified research expenses of the acquiring taxpayer. In addition, the credit allowable to each member of a controlled group of corporations or each member of a group of businesses under common control is determined on a proportionate basis to its share of the aggregate qualified research expenses.

Effective Date

The extension of the credit is effective for amounts paid or incurred after December 31, 2011. The modification to the special rules is effective for taxable years beginning after December 31, 2011.

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[44] Sec. 280C(c).

[45] Sec. 280C(c)(3).

2. Determination of applicable percentage for the low-income housing tax credit (sec. 202 of the bill and sec. 42 of the Code)

Present Law

In general

The low-income housing credit may be claimed over a 10-year credit period after each low-income building is placed-in-service. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building.

Present value credit

The calculation of the applicable percentage is designed to produce a credit equal to: (1) 70 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is not Federally subsidized (the "70-percent credit"); or (2) 30 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is Federally subsidized and existing housing that is substantially rehabilitated (the "30-percent credit"). Where existing housing is substantially rehabilitated, the existing housing is eligible for the 30-percent credit and the qualified rehabilitation expenses (if not Federally subsidized) are eligible for the 70-percent credit.

Calculation of the applicable percentage

In general

The credit percentage for a low-income building is set for the earlier of: (1) the month the building is placed in service; or (2) at the election of the taxpayer, (a) the month the taxpayer and the housing credit agency enter into a binding agreement with respect to such building for a credit allocation, or (b) in the case of a tax-exempt bond-financed project for which no credit allocation is required, the month in which the tax-exempt bonds are issued.

These credit percentages (used for the 70-percent credit and 30-percent credit) are adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the Applicable Federal Rates for mid-term and long-term obligations for the month the building is placed in service. The discounting formula assumes that each credit is received on the last day of each year and that the present value is computed on the last day of the first year. In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.

Special rule

Under this rule the applicable percentage is set at a minimum of 9 percent for newly constructed non-Federally subsidized buildings placed in service after July 30, 2008, and before December 31, 2013.

Reasons for Change

Historically low Federal interest rates result in lower credit amounts for low-income housing tax credit properties. To reduce uncertainty and financial risk in the adjustable rate, the Committee believes that an extension of the temporary minimum applicable percentage for newly constructed non-Federally subsidized building is warranted.

Explanation of Provision

The provision extends the temporary minimum applicable percentage of 9 percent for newly constructed non-Federally subsidized buildings with respect to which credit allocations are made before January 1, 2014.

Effective Date

The provision is effective on the date of enactment.

3. Treatment of basic housing allowances for purposes of income eligibility rules (sec. 203 of the bill and sec. 42 of the Code)

Present Law

In general

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the "20-50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the "40-60 test"). These income figures are adjusted for family size.

Rule for income determinations before July 30, 2008 and on or after January 1, 2012

The recipients of the military basic housing allowance must include these amounts for purposes of low-income credit eligibility income test, as described above.

Special rule for income determination before January 1, 2012

Under the provision the basic housing allowance (*i.e.*, payments under 37 U.S.C. sec. 403) is not included in income for the low-income credit income eligibility rules. The provision is limited in application to qualified buildings. A qualified building is defined as any building located:

1. any county which contains a qualified military installation to which the number of members of the Armed Forces assigned to units based out of such qualified military

installation has increased by 20 percent or more as of June 1, 2008, over the personnel level on December 31, 2005; and

2. any counties adjacent to county described in (1), above.

For these purposes, a qualified military installation is any military installation or facility with at least 1000 members of the Armed Forces assigned to it.

The provision applies to income determinations: (1) made after July 30, 2008, and before January 1, 2012, in the case of qualified buildings which received credit allocations on or before July 30, 2008, or qualified buildings placed in service on or before July 30, 2008, to the extent a credit allocation was not required with respect to such building by reason of 42(h)(4) (*i.e.* such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued before July 30, 2008; and (2) made after July 30, 2008, in the case of qualified buildings which received credit allocations after July 30, 2008 and before January 1, 2012, or qualified buildings placed in service after July 30, 2008, and before January 1, 2012, to the extent a credit allocation was not required with respect to such qualified building by reason of 42(h)(4) (*i.e.* such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued after July 30, 2008, and before January 1, 2012.

Reasons for Change

The Committee believes that more time is necessary for market forces to create adequate housing in communities affected by the base closing legislation. In the meantime, the Committee believes that encouraging owners of low-income housing credit properties to rent such subsidized units to military families is appropriate.

Explanation of Provision

The provision extends the special rule for two additional years (through December 31, 2013).

Effective Date

The provision is effective for income determinations on or after January 1, 2012.

4. Indian employment tax credit (sec. 204 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.[46] The credit is equal to 20 percent of the excess of

[46] Sec. 45A.

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[47] or section 4(10) of the Indian Child Welfare Act of 1978.[48] 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 is $45,000 for 2011). 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 five 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 in taxable years that begin before January 1, 2012.

Reasons for Change

To further encourage employment on Indian reservations, the Committee believes it is appropriate to extend the Indian employment credit an additional two years.

Explanation of Provision

The provision extends for two years the present-law employment credit provision (through taxable years beginning on or before December 31, 2013).

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[47] Pub. L. No. 93-262.

[48] Pub. L. No. 95-608.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

5. New markets tax credit (sec. 205 of the bill and sec. 45D of the Code)

Present Law

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[49] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years.[50] The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.[51] The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed.[52]

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE.[53] A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder.[54] Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a

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[49] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554.

[50] Sec. 45D(a)(2).

[51] Sec. 45D(a)(3).

[52] Sec. 45D(g).

[53] Sec. 45D(c).

[54] Sec. 45D(b).

qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.[55]

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income.[56] For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary is authorized to designate "targeted populations" as low-income communities for purposes of the new markets tax credit.[57] For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994[58] (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of—80 percent of the area median family income, or 80 percent of the statewide non-metropolitan area median family income.[59] A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391 of the Code, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of the business is used in a low-income community; (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community; and (4) less than five

[55] Sec. 45D(d).

[56] Sec. 45D(e).

[57] Sec. 45D(e)(2).

[58] Pub. L. No. 103-325.

[59] Pub. L. No. 103-325.

percent of the average of the aggregate unadjusted bases of the property of the business is attributable to certain financial property or to certain collectibles.[60]

The maximum annual amount of qualified equity investments was $3.5 billion for calendar years 2010 and 2011. The new markets tax credit expired on December 31, 2011.

Reasons for Change

The Committee believes that the new markets tax credit has proved to be an effective means of providing equity and other investments to benefit businesses in low income communities, and that it is appropriate to provide for the allocation of additional tax credit authority for another two calendar years.

Explanation of Provision

The provision extends the new markets tax credit for two years, through 2013, permitting up to $3.5 billion in qualified equity investments for each of the 2012 and 2013 calendar years. The provision also extends for two years, through 2018, the carryover period for unused new markets tax credits.

Effective Date

The provision applies to calendar years beginning after December 31, 2011.

6. Railroad track maintenance credit (sec. 206 of the bill and sec. 45G of the Code)

Present Law

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during taxable years beginning before January 1, 2012.[61] The credit is limited to the product of $3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year, and (2) assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the taxable year.[62] Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. The credit also may reduce a taxpayer's tax liability below its tentative minimum tax.[63]

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[60] Sec. 45D(d)(2).

[61] Secs. 45G(a), (f).

[62] Sec. 45G(b)(1).

[63] Sec. 38(c)(4).

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).[64]

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only with respect to miles of railroad track assigned to such person by such railroad under the provision.[65]

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.[66]

Reasons for Change

The Committee believes that Class II and Class III railroads are an important part of the nation's railway system. Therefore, the Committee believes that this incentive for railroad track maintenance expenditures should be extended.

Explanation of Provision

The provision extends the present law credit for two years, for qualified railroad track maintenance expenses paid or incurred during taxable years beginning after December 31, 2011 and before January 1, 2014.

Effective Date

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2011.

7. Mine rescue team training credit (sec. 207 of the bill and sec. 45N of the Code)

Present Law

An eligible employer may claim a general business credit against income tax with respect to each qualified mine rescue team employee equal to the lesser of: (1) 20 percent of the amount paid or incurred by the taxpayer during the taxable year with respect to the training program costs of the qualified mine rescue team employee (including the wages of the employee while attending the program); or (2) $10,000. A qualified mine rescue team employee is any full-time employee of the taxpayer who is a miner eligible for more than six months of a taxable year to

[64] Sec. 45G(d).

[65] Sec. 45G(c).

[66] Sec. 45G(e)(1).

serve as a mine rescue team member by virtue of either having completed the initial 20 hour course of instruction prescribed by the Mine Safety and Health Administration's Office of Educational Policy and Development, or receiving at least 40 hours of refresher training in such instruction. The credit is not allowable for purposes of computing the alternative minimum tax.[67]

An eligible employer is any taxpayer which employs individuals as miners in underground mines in the United States. The term "wages" has the meaning given to such term by section 3306(b)[68] (determined without regard to any dollar limitation contained in that section).

No deduction is allowed for the portion of the expenses otherwise deductible that is equal to the amount of the credit.[69] The credit does not apply to taxable years beginning after December 31, 2011. Additionally, the credit may not offset the alternative minimum tax.

Reasons for Change

The Committee believes that training mine rescue team employees will help ensure a positive outcome for individuals operating in and around a mine in the event of an accident. Therefore, the Committee believes that this incentive for costs incurred to train mine rescue teams should be extended.

Explanation of Provision

The provision extends the credit for two years through taxable years beginning on or before December 31, 2013.

Effective Date

The provision generally is effective for taxable years beginning after December 31, 2011.

8. Employer wage credit for employees who are active duty members of the uniformed Services (sec. 208 of the bill and sec. 45P of the Code)

Present Law

Differential pay

In general, compensation paid by an employer to an employee is deductible by the employer under section 162(a)(1), unless the expense must be capitalized. In the case of an employee who is called to active duty with respect to the armed forces of the United States, some employers voluntarily pay the employee the difference between the compensation that the

[67] Sec. 38(c).

[68] Section 3306(b) defines wages for purposes of Federal Unemployment Tax.

[69] Sec. 280C(e).

employer would have paid to the employee during the period of military service less the amount of pay received by the employee from the military. This payment by the employer is often referred to as "differential pay."

Wage credit for differential pay

If an employer qualifies as an eligible small business employer, the employer is allowed to take a credit against its income tax liability for a taxable year in an amount equal to 20 percent of the sum of the eligible differential wage payments for each of the employer's qualified employees for the taxable year.[70]

An eligible small business employer means, with respect to a taxable year, any taxpayer which: (1) employed on average less than 50 employees on business days during the taxable year; and (2) under a written plan of the taxpayer, provides eligible differential wage payments to every qualified employee of the taxpayer. Taxpayers under common control are aggregated for purposes of determining whether a taxpayer is an eligible small business employer. The credit is not available with respect to a taxpayer who has failed to comply with the employment and reemployment rights of members of the uniformed services (as provided under Chapter 43 of Title 38 of the United States Code).

Differential wage payment means any payment which: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services of the United States while on active duty for a period of more than 30 days; and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer. The term eligible differential wage payments means so much of the differential wage payments paid to a qualified employee as does not exceed $20,000. A qualified employee is an individual who has been an employee for the 91-day period immediately preceding the period for which any differential wage payment is made.

No deduction may be taken for that portion of compensation which is equal to the credit. In addition, the amount of any other credit against the income tax otherwise allowable with respect to compensation paid to an employee must be reduced by the differential wage payment credit allowed with respect to such employee.

The differential wage payment credit is part of the general business credit, and thus this credit is subject to the rules applicable to business credits. For example, an unused credit generally may be carried back to the taxable year that precedes an unused credit year or carried forward to each of the 20 taxable years following the unused credit year. Further, the credit is not allowable against a taxpayer's alternative minimum tax liability.

Rules similar to the rules in section 52(c), which bars the work opportunity tax credit for tax-exempt organizations other than certain farmer's cooperatives, apply to the differential wage payment credit. Additionally, rules similar to the rules in section 52(e), which limits the work

[70] Sec. 45P.

opportunity tax credit allowable to regulated investment companies, real estate investment trusts, and certain cooperatives, apply to the differential wage payment credit.

The credit is available with respect to amounts paid after June 17, 2008[71] and before January 1, 2012.

Reasons for Change

The Committee believes that it is still appropriate to encourage small employers to make differential wage payments to employees during any period that the employee is called to duty for a period of more than 30 days in the uniform services.

Explanation of Provision

The provision extends the availability of the credit for two years to amounts paid before January 1, 2014.

Effective Date

The provision applies to payments made after December 31, 2011.

9. Work opportunity tax credit (sec. 209 of the bill and secs. 51 and 52 of the Code)

Present Law

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

(1) Families receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (*e.g.*, a State employment agency) as being a member of a family eligible to receive benefits

[71] This date is the date of enactment of the Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110–245.

under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified veteran

Prior to enactment of the "VOW to Hire Heroes Act of 2011" (the "VOW Act"),[72] there were two subcategories of qualified veterans to whom wages paid by an employer were eligible for the credit. Employers who hired veterans who were eligible to receive assistance under a supplemental nutritional assistance program were entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages paid to such individual.[73] Employers who hired veterans who were entitled to compensation for a service-connected disability were entitled to a maximum wage credit of 40 percent of $12,000 of qualified first-year wages paid to such individual.[74]

The VOW Act modified the work opportunity credit with respect to qualified veterans, by adding additional subcategories. There are now five subcategories of qualified veterans: (1) in the case of veterans who were eligible to receive assistance under a supplemental nutritional assistance program (for at least a three month period during the year prior to the hiring date) the employer is entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of $12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service connected disability, and who has been unemployed for an aggregate of at least six months during the one year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of $24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive)

[72] Pub. L. No. 112-56 (Nov. 21, 2011).

[73] For these purposes, a qualified veteran must be certified by the designated local agency as a member of a family receiving assistance under a supplemental nutrition assistance program under the Food and Nutrition Act of 2008 for a period of at least three months part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a supplemental nutrition assistance program under the Food and Nutrition Act of 2008.

[74] The qualified veteran must be certified as entitled to compensation for a service-connected disability and (1) have a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States; or (2) have been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring. For these purposes, being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S. Code, which means having a disability rating of 10 percent or higher for service connected injuries.

during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $14,000 of qualified first-year wages.

A veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not a qualified veteran if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(3) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law; and (2) having a hiring date within one year of release from prison or the date of conviction.

(4) Designated community resident

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community or a rural renewal community. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990-1994 and 1995-1999. Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community or a rural renewal community.

(5) Vocational rehabilitation referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a State plan approved under the Rehabilitation Act of 1973; (b) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code; or (c) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified summer youth employee

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15; (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date; (3) who has not been an employee of that employer before; and (4) who is certified by the designated local agency as having a

principal place of abode within an empowerment zone, enterprise community, or renewal community. As with designated community residents, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified supplemental nutrition assistance program benefits recipient

A qualified supplemental nutrition assistance program benefits recipient is an individual at least age 18 but not yet age 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food and nutrition program under the Food and Nutrition Act of 2008 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food and nutrition assistance under section 6(o) of the Food and Nutrition Act of 2008, the six-month requirement is replaced with a requirement that the family has been receiving food and nutrition assistance for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food and nutrition assistance program under the Food and Nutrition Act of 2008.

(8) Qualified SSI recipient

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income ("SSI") benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-term family assistance recipient

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) a member 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)[75] if the individual is hired within two years after the date that the 18-month total is reached; or (3) a member of a family who is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within two years after the Federal or State time limits made the family ineligible for family assistance.

[75] The welfare-to-work tax credit was consolidated into the work opportunity tax credit in the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, for qualified individuals who begin to work for an employer after December 31, 2006.

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.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients 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). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

In the case of a qualified veteran who is entitled to compensation for a service connected disability, the credit equals 40 percent of $12,000 of qualified first-year wages. This expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food and nutrition assistance program, as defined under present law.

Certification rules

Generally, an individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

An otherwise qualified unemployed veteran is treated as certified by the designated local agency as having aggregate periods of unemployment (whichever is applicable under the qualified veterans rules described above) if such veteran is certified by such agency as being in receipt of unemployment compensation under a State or Federal law for such applicable periods. The Secretary of the Treasury is authorized to provide alternative methods of certification for unemployed veterans.

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.

Qualified tax-exempt organizations employing qualified veterans

The credit is not available to qualified tax-exempt organizations other than those employing qualified veterans. The special rules, described below, were enacted in the VOW Act.

If a qualified tax-exempt organization employs a qualified veteran (as described above) a tax credit against the FICA taxes of the organization is allowed on the wages of the qualified veteran which are paid for the veteran's services in furtherance of the activities related to the function or purpose constituting the basis of the organization's exemption under section 501.

The credit available to such tax-exempt employer for qualified wages paid to a qualified veteran equals 26 percent (16.25 percent for employment of 400 hours or less) of qualified first-year wages. The amount of qualified first-year wages eligible for the credit is the same as those for non-tax-exempt employers (*i.e.*, $6,000, $12,000, $14,000 or $24,000, depending on the category of qualified veteran).

A qualified tax-exempt organization means an employer that is described in section 501(c) and exempt from tax under section 501(a).

The Social Security Trust Funds are held harmless from the effects of this provision by a transfer from the Treasury General Fund.

Treatment of possessions

The VOW Act provided a reimbursement mechanism for the U.S. possessions (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the United States Virgin Islands). The Treasury Secretary is to pay to each mirror code possession (Guam, the Commonwealth of the Northern Mariana Islands, and the United States Virgin Islands) an amount equal to the loss to that possession as a result of the VOW Act changes to the qualified veterans rules. Similarly, the Treasury Secretary is to pay to each non-mirror Code possession (American Samoa and the Commonwealth of Puerto Rico) the amount that the Secretary estimates as being equal to the loss to that possession that would have occurred as a result of the VOW Act changes if a mirror code tax system had been in effect in that possession. The Secretary will make this payment to a non-mirror Code possession only if that possession establishes to the satisfaction of the Secretary that the

possession has implemented (or, at the discretion of the Secretary, will implement) an income tax benefit that is substantially equivalent to the qualified veterans credit allowed under the VOW Act modifications.

An employer that is allowed a credit against U.S. tax under the VOW Act changes with respect to a qualified veteran must reduce the amount of the credit claimed by the amount of any credit (or, in the case of a non-mirror Code possession, another tax benefit) that the employer claims against its possession income tax.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, 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

Generally, the work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2011. The work opportunity tax credit for employers of qualified veterans is not available for such individuals who begin work for an employer after December 31, 2012.

Reasons for Change

Given the level of unemployment and general economic conditions, the Committee believes that the credit should be extended.

Explanation of Provision

The credit is extended for all eligible categories through December 31, 2013.

Effective Date

The provision is effective for individuals who begin work for the employer after December 31, 2011 (in the case of certain qualified veterans after December 31, 2012).

10. Qualified zone academy bonds (sec. 210 of the bill and sec. 54E 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. These can include tax-exempt bonds which finance public schools.[76] An issuer must file with the Internal Revenue Service certain information about the bonds issued in order for that bond issue to be tax-exempt.[77] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[78] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[79] In general, arbitrage profits may be earned only during specified periods (*e.g.*, defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (*e.g.*, "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue "qualified zone academy bonds."[80] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2008, $1,400 million in 2009 and 2010, and $400 million in 2011. Each calendar years bond limitation is allocated 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.

A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

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[76] Sec. 103.

[77] Sec. 149(e).

[78] Sec. 103(a) and (b)(2).

[79] Sec. 148.

[80] See secs. 54E and 1397E.

Qualified zone academy bonds are a type of qualified tax credit bond and subject to the general rules applicable to qualified tax credit bonds.[81] 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.[82] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on 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 100 percent of the available project 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.

Under section 6431 of the Code, an issuer of specified tax credit bonds , may elect to receive a payment in lieu of a credit being allowed to the holder of the bond. This provision is not available for qualified zone academy bond allocations from the 2011 national limitation or any carry forward of the 2011 allocation.[83]

Reasons for Change

The Committee believes that the past experience with the program warrants its extension.

Explanation of Provision

The provision extends the qualified zone academy bond program for two years. The proposal authorizes issuance of up to $400 million of qualified zone academy bonds per year for 2012 and 2013.

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[81] Sec. 54A.

[82] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

[83] Sec. 6431(f)(3)(A)(iii).

The issuer election to receive a payment in lieu of providing a tax credit to the holder of the qualified zone academy bond is not available for bonds issued with the 2012 or 2013 national limitations. The proposal has no effect on bonds issued with limitation carried forward from 2009 or 2010.

Effective Date

The provision applies to obligations issued after December 31, 2011.

11. 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (sec. 211 of the bill and sec. 168 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-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[84] 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 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, qualified restaurant property, and qualified retail improvement property.

[84] Sec. 168.

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, 2012. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[85] 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. 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 non-recognition treatment.

Qualified leasehold improvement property is recovered using the straight-line method and a half-year convention. Qualified leasehold improvement property placed in service after December 31, 2011 is subject to the general rules described above.

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, 2012. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building, if 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.[86] Qualified restaurant property is recovered using the straight-line method and a half-year convention. Additionally, qualified restaurant property is not eligible for bonus depreciation.[87] Qualified restaurant property placed in service after December 31, 2011 is subject to the general rules described above.

Qualified retail improvement property

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period and for qualified retail improvement property placed in service before January 1, 2012. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public[88] and is used in the retail

[85] Sec. 168(e)(6).

[86] Sec. 168(e)(7).

[87] Property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property is eligible for bonus depreciation.

[88] Improvements to portions of a building not open to the general public (*e.g.*, stock room in back of retail space) do not qualify under the provision.

trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.[89] Qualified retail 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. In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. It is generally intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.

Qualified retail improvement property is recovered using the straight-line method and a half-year convention. Additionally, qualified retail improvement property is not eligible for bonus depreciation.[90] Qualified retail improvement property placed in service after December 31, 2011 is subject to the general rules described above.

Reasons for Change

The Committee believes that taxpayers should not be required to recover the costs of certain leasehold improvements beyond the useful life of the investment. The 39-year recovery period for leasehold improvements for property placed in service after December 31, 2007, extends beyond the useful life of many such investments. Although lease terms differ, the Committee believes that lease terms for commercial real estate are also typically shorter than the 39-year recovery period. In the interests of simplicity and administrability, a uniform period for recovery of leasehold improvements is desirable. Therefore, the provision extends the 15-year recovery period for leasehold improvements.

The Committee also believes that unlike other commercial buildings, restaurant buildings generally are more specialized structures. Restaurants also experience considerably more traffic, and remain open longer than most commercial properties. This daily use causes rapid deterioration of restaurant properties and forces restaurateurs to constantly repair and upgrade their facilities. As such, restaurant facilities generally have a shorter life span than other commercial establishments. The provision extends the 15-year recovery period for

[89] Sec. 168(e)(8).

[90] Property that satisfies the definition of both qualified leasehold improvement property and qualified retail property is eligible for bonus depreciation.

improvements made to restaurant buildings and continues to apply the 15-year recovery period to new restaurants, to more accurately reflect the true economic life of such properties.

The Committee believes that taxpayers should not be required to recover the costs of certain improvements beyond the useful life of the investment. The 39-year recovery period for improvements to owner occupied (*i.e.*, not leased) retail property extends beyond the useful life of many such investments. Additionally, the Committee believes that retailers should not be treated differently based on whether the building in which they operate is owned or leased. As many small business retailers own the building in which they operate their business, the Committee believes this provision will provide relief to small businesses. Therefore, the provision extends the 15-year recovery period for qualified retail improvements.

Explanation of Provision

The present law provisions for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property are extended for two years to apply to property placed in service on or before December 31, 2013.

Effective Date

The provision is effective for property placed in service after December 31, 2011.

12. 7-year recovery period for motorsports entertainment complexes (sec. 212 of the bill and sec. 168 of the Code)

Present Law

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-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[91] 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 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. Land improvements (such as roads and fences) are recovered over 15 years. An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years. Additionally, a motorsports entertainment complex placed in service on or before December 31, 2011 is assigned a recovery period of seven years.[92] For these purposes, a motorsports entertainment

[91] Sec. 168.

[92] Sec. 168(e)(3)(C)(ii).

complex means a racing track facility which is permanently situated on land and which during the 36-month period following its placed-in-service date hosts a racing event.[93] The term motorsports entertainment complex also includes ancillary facilities, land improvements (*e.g.*, parking lots, sidewalks, fences), support facilities (*e.g.*, food and beverage retailing, souvenir vending), and appurtenances associated with such facilities (*e.g.*, ticket booths, grandstands).

Reasons for Change

The Committee believes that extending the depreciation incentive will encourage economic development. Thus, the provision extends the seven-year recovery period for motorsports entertainment complex property.

Explanation of Provision

The provision extends the present-law seven-year recovery period for motorsports entertainment complexes for two years to apply to property placed in service before January 1, 2014.

Effective Date

The provision is effective for property placed in service after December 31, 2011.

13. Accelerated depreciation for business property on an Indian reservation (sec. 213 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:

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

[93] Sec. 168(i)(15).

"Qualified Indian reservation property" eligible for accelerated depreciation includes property described in the table above 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;[94] and (4) is not property placed in service for purposes of conducting gaming activities.[95] 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).[96]

An "Indian reservation" means a reservation as defined in section 3(d) of the Indian Financing Act of 1974[97] or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).[98] 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 qualified Indian reservation property is available with respect to property placed in service before January 1, 2012.

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 two years the present-law accelerated MACRS recovery periods for qualified Indian reservation property to apply to property placed in service before January 1, 2014.

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[94] For these purposes, related persons is defined in Sec. 465(b)(3)(C).

[95] Sec. 168(j)(4)(A).

[96] Sec. 168(j)(4)(C).

[97] Pub. L. No. 93-262.

[98] Pub. L. No. 95-608.

Effective Date

The provision is effective for property placed in service after December 31, 2011.

14. Enhanced charitable deduction for contributions of food inventory (sec. 214 of the bill and sec. 170 of the Code)

Present Law

Charitable contributions in general

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization.[99]

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property to a qualified charity are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

General rules regarding contributions of inventory

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

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (*i.e.*, basis plus one-half of fair market value in excess of basis) or (2) two times basis.[100] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[101] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.[102] In the case of contributed property subject to the Federal Food, Drug, and

[99] Sec. 170.

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

[101] Sec. 170(b)(2).

[102] Sec. 170(e)(3)(A)(i)-(iii).

Cosmetic Act, as amended, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.[103]

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[104]

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.[105]

Temporary rule expanding and modifying the enhanced deduction for contributions of food inventory

Under a special temporary provision, any taxpayer, whether or not a C corporation, engaged in a trade or business is eligible to claim the enhanced deduction for donations of food inventory.[106] For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporation) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.[107]

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[103] Sec. 170(e)(3)(A)(iv).

[104] Treas. Reg. sec. 1.170A-4A(c)(3).

[105] *Lucky Stores Inc. v. Commissioner,* 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).

[106] Sec. 170(e)(3)(C).

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

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

The temporary provision does not apply to contributions made after December 31, 2011.

Reasons for Change

The Committee believes that charitable organizations benefit from charitable contributions of food inventory by non C corporations and that the enhanced deduction is a useful incentive for the making of such contributions. Accordingly, the Committee believes it is appropriate to extend the special rule for charitable contributions of food inventory for two years.

Explanation of Provision

The provision extends the expansion of, and modifications to, the enhanced deduction for charitable contributions of food inventory to contributions made before January 1, 2014.

Effective Date

The provision is effective for contributions made after December 31, 2011.

15. Increased expensing for small business depreciable assets (sec. 215 of the bill and sec. 179 of the Code)

Present Law

A taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation.[108] For taxable years beginning in 2012, the maximum amount a taxpayer may expense is $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 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 $500,000.[109] The $125,000 and $500,000 amounts are indexed for inflation occurring since 2006.[110] The indexed amounts for 2012 are $139,000 and $560,000. 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.

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[108] Additional section 179 incentives have been provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)). In addition, section 179(e) provides for an enhanced section 179 deduction for qualified disaster assistance property.

[109] Sec. 179(b)(2).

[110] Sec. 179(b)(6).

Off-the-shelf computer software placed in service in taxable years beginning before 2013 also is treated as qualifying property.

For taxable years beginning in 2010 and 2011, the maximum amount a taxpayer may expense is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 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 $2,000,000. For taxable years beginning in 2010 and 2011, qualifying property also includes certain real property (*i.e.*, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).[111] Of the $500,000 expense amount available under section 179 for 2010 and 2011, the maximum amount available with respect to qualified real property is $250,000 for each taxable year.

For taxable years beginning in 2013 and thereafter, a taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year, subject to limitation. 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 for inflation. In general, qualifying property is defined as depreciable tangible personal property (not including off-the-shelf computer software) that is purchased for use in the active conduct of a trade or business.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such 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 limitations). However amounts attributable to qualified real property that are disallowed under the trade or business income limitation may only be carried over to taxable years in which the definition of eligible section 179 property includes qualified real property.[112] Thus, if a taxpayer's section 179 deduction for 2010 with respect to qualified real property is limited by the taxpayer's active trade or business income, such disallowed amount may be carried over to 2011. Any such carryover amounts that are not used in 2011 are treated as property placed in service in 2011 for purposes of computing depreciation. That is, the unused carryover amount from 2010 is considered placed in service on the first day of the 2011 taxable year.[113]

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[111] Sec. 179(f).

[112] Section 179(f)(4) details the special rules that apply to disallowed amounts.

[113] For example, assume that during 2010, a company's only asset purchases are section 179-eligible equipment costing $100,000 and qualifying leasehold improvements costing $200,000. Assume the company has no other asset purchases during 2010, and has a taxable income limitation of $150,000. The maximum section 179 deduction the company can claim for 2010 is $150,000, which is allocated pro rata between the properties, such that the carryover to 2011 is allocated $100,000 to the qualified leasehold improvements and $50,000 to the equipment.

Assume further that in 2011, the company had no asset purchases and had taxable income of $-0-. The $100,000 carryover from 2010 attributable to qualified leasehold improvements is treated as placed in service as of

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.[114] In general, any election or specification made with respect to any property may not be revoked except with the consent of the Commissioner. However, an election or specification under section 179 may be revoked by the taxpayer without consent of the Commissioner for taxable years beginning after 2002 and before 2013.[115]

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 tangible 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 depreciation recordkeeping requirements with respect to expensed property. In order to increase the value of these benefits and to increase the number of taxpayers eligible, the provision increases the amount allowed to be expensed under section 179 and increases the amount of the phase-out threshold.

The Committee also believes that qualified real property (*i.e.*, leasehold improvement property, restaurant property, and retail improvement property) should continue to be included in the section 179 expensing provision to encourage small businesses to invest in these types of real property. Further, the Committee believes that purchased computer software should continue to be included in the section 179 expensing provision so that it is not disadvantaged relative to developed software. In addition, the Committee believes that the process of making and revoking section 179 elections should continue to be simpler and more efficient for taxpayers by eliminating the requirement of the consent of the Commissioner.

Explanation of Provision

The provision provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2012 and 2013, is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 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 $2,000,000.

In addition, the provision extends, for taxable years beginning in 2013, the treatment of off-the-shelf computer software as qualifying property. The provision also extends the treatment of qualified real property as eligible section 179 property for taxable years beginning in 2012 and 2013, including the limitation on carryovers and the maximum amount of $250,000 for each taxable year. The provision makes a technical drafting correction by clarifying that for the last

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the first day of the company's 2011 taxable year. The $50,000 carryover allocated to equipment is carried over to 2012 under section 179(b)(3)(B).

[114] Sec. 179(c)(1).

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

taxable year beginning in 2013, the taxable income limitation[116] is computed without regard to any additional depreciation expense resulting from the application of the carryover limitation of section 179(f)(4). For taxable years beginning in 2013, the provision continues to permit a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

16. Election to expense mine safety equipment (sec. 216 of the bill and sec. 179E of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[117] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. Present law provides that the maximum amount a taxpayer may expense for taxable years beginning in 2012 is $125,000 of the cost of the qualifying property for the taxable year. 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.[118] The $125,000 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 $500,000.

A taxpayer may elect to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the taxable year in which the equipment is placed in service.[119] The deduction under section 179E is allowed for both regular and alternative

[116] Sec. 179(b)(3).

[117] Sec. 168.

[118] The definition of qualifying property was temporarily (for 2010 and 2011) expanded to include up to $250,000 of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. See section 179(c).

[119] Sec. 179E(a).

minimum tax purposes, including adjusted current earnings. In computing earnings and profits, the amount deductible under section 179E is allowed as a deduction ratably over five taxable years beginning with the year the amount is deductible under section 179E.[120]

"Qualified advanced mine safety equipment property" means any advanced mine safety equipment property for use in any underground mine located in the United States the original use of which commences with the taxpayer and which is placed in service before January 1, 2012.[121]

Advanced mine safety equipment property means any of the following: (1) emergency communication technology or devices used to allow a miner to maintain constant communication with an individual who is not in the mine; (2) electronic identification and location devices that allow individuals not in the mine to track at all times the movements and location of miners working in or at the mine; (3) emergency oxygen-generating, self-rescue devices that provide oxygen for at least 90 minutes; (4) pre-positioned supplies of oxygen providing each miner on a shift the ability to survive for at least 48 hours; and (5) comprehensive atmospheric monitoring systems that monitor the levels of carbon monoxide, methane and oxygen that are present in all areas of the mine and that can detect smoke in the case of a fire in a mine.[122]

The portion of the cost of any property with respect to which an expensing election under section 179 is made may not be taken into account for purposes of the 50-percent deduction under section 179E.[123] In addition, a taxpayer making an election under section 179E must file with the Secretary a report containing information with respect to the operation of the mines of the taxpayer as required by the Secretary.[124]

Reasons for Change

The Committee believes that mine safety equipment is vital to ensuring a safe workplace for the nation's underground mine workforce. Therefore, the Committee believes that this incentive for mine safety equipment property should be extended.

Explanation of Provision

The provision extends for two years (through December 31, 2013) the present-law placed in service date relating to expensing of mine safety equipment.

Effective Date

The provision applies to property placed in service after December 31, 2011.

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[120] Sec. 312(k)(3).

[121] Secs. 179E(c) and (g).

[122] Sec. 179E(d).

[123] Sec. 179E(e).

[124] Sec. 179E(f).

17. Special expensing rules for certain film and television productions (sec. 217 of the bill and sec. 181 of the Code)

Present Law

The modified accelerated cost recovery system ("MACRS") does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197, which allows amortization for certain intangible property, does not apply to some intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost recovery of such property may be determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property. A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. Section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation.

Under section 181, taxpayers may elect[125] to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2012, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances.[126] Taxpayers may elect to deduct up to $15 million of the aggregate cost of the film or television production under this section.[127] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[128]

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant

[125] See Temp. Treas. Reg. section 1.181-2T for rules on making an election under this section.

[126] For this purpose, a production is treated as commencing on the first date of principal photography.

[127] Sec. 181(a)(2)(A).

[128] Sec. 181(a)(2)(B).

production personnel.[129] The term "compensation" does not include participations and residuals (as defined in section 167(g)(7)(B)).[130] With respect to property which is one or more episodes in a television series, each episode is treated as a separate production and only the first 44 episodes qualify under the provision.[131] Qualified property does not include sexually explicit productions as defined by section 2257 of title 18 of the U.S. Code.[132]

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.[133]

Reasons for Change

The Committee believes that section 181 encourages domestic film production and that the provision should be extended. The issue of runaway production affects all productions, regardless of cost, and therefore the Committee believes that it is appropriate to treat as an expense the first $15 million ($20 million in certain cases) of production costs of otherwise qualified films.

Explanation of Provision

The provision extends the present-law expensing provision for two years, to qualified film and television productions commencing prior to January 1, 2014.

Effective Date

The provision applies to qualified film and television productions commencing after December 31, 2011.

18. Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sec. 218 of the bill and sec. 199 of the Code)

Present Law

General

Present law provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income for the taxable year. For taxpayers subject to the

[129] Sec. 181(d)(3)(A).

[130] Sec. 181(d)(3)(B).

[131] Sec. 181(d)(2)(B).

[132] Sec. 181(d)(2)(C).

[133] Sec. 1245(a)(2)(C).

35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[134] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[135] produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

The amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[136] Wages paid to bona fide residents of Puerto Rico generally are not included in the definition of wages for purposes of computing the wage limitation amount.[137]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia.[138] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts

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[134] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[135] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

[136] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

[137] Section 3401(a)(8)(C) excludes wages paid to United States citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.

[138] Sec. 7701(a)(9).

from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations.[139] In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[140]

The special rules for Puerto Rico apply only with respect to the first six taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2012.

Reasons for Change

The Committee believes that, notwithstanding expiration of the Puerto Rico and possession tax credit and the Puerto Rico economic activity credit for taxable years beginning after 2005, the Code should promote economic activity in Puerto Rico. Consequently, the Committee believes that it is appropriate to treat Puerto Rico as part of the United States for purposes of the domestic production activities deduction.

Explanation of Provision

The provision extends the special domestic production activities rules for Puerto Rico to apply for the first eight taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2014.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

19. Modification of tax treatment of certain payments to controlling exempt organizations (sec. 219 of the bill and sec. 512 of the Code)

Present Law

In general, organizations exempt from Federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[141] In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.[142]

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[139] Sec. 199(d)(8)(A).

[140] Sec. 199(d)(8)(B).

[141] Sec. 511.

[142] Sec. 512(b).

Section 512(b)(13) provides special rules regarding income derived by an exempt organization from a controlled subsidiary. In general, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business taxable income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt). However, a special rule provides that, for payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of section 512(b)(13) applies only to the portion of payments received or accrued in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of section 482 (*i.e.*, at arm's length).[143] In addition, the special rule imposes a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, "control" means ownership of more than 50 percent of the profits, capital, or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

The special rule does not apply to payments received or accrued after December 31, 2011.

Reasons for Change

The Committee believes it is desirable to extend the special rule for an additional two years.

Explanation of Provision

The provision extends the special rule for two years to payments received or accrued before January 1, 2014. Accordingly, under the provision, payments of rent, royalties, annuities, or interest income by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of section 482 (*i.e.*, at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

[143] Sec. 512(b)(13)(E).

Effective Date

The provision is effective for payments received or accrued after December 31, 2011.

20. Treatment of certain dividends of regulated investment companies (sec. 220 of the bill and sec. 871(k) of the Code)

Present Law

In general

A regulated investment company ("RIC") is an entity that meets certain requirements (including a requirement that its income generally be derived from passive investments such as dividends and interest and a requirement that it distribute at least 90 percent of its income) and that elects to be taxed under a special tax regime. Unlike an ordinary corporation, an entity that is taxed as a RIC can deduct amounts paid to its shareholders as dividends. In this manner, tax on RIC income is generally not paid by the RIC but rather by its shareholders. Income of a RIC distributed to shareholders as dividends is generally treated as an ordinary income dividend by those shareholders, unless other special rules apply. Dividends received by foreign persons from a RIC are generally subject to gross-basis tax under sections 871(a) or 881, and the RIC payor of such dividends is obligated to withhold such tax under sections 1441 and 1442.

Under a temporary provision of prior law, a RIC that earned certain interest income that generally would not be subject to U.S. tax if earned by a foreign person directly could, to the extent of such net interest income, designate a dividend it paid as derived from such interest income for purposes of the treatment of a foreign RIC shareholder. A foreign person who is a shareholder in the RIC generally could treat such a dividend as exempt from gross-basis U.S. tax. Also, subject to certain requirements, the RIC was exempt from withholding the gross-basis tax on such dividends. Similar rules applied with respect to the designation of certain short-term capital gain dividends. However, these provisions relating to dividends with respect to interest income and short-term capital gain of the RIC have expired, and therefore do not apply to dividends with respect to any taxable year of a RIC beginning after December 31, 2011.[144]

Reasons for Change

The Committee believes it is desirable to extend the provision for an additional two years.

Explanation of Provision

The provision extends the rules exempting from gross basis tax and from withholding tax the interest-related dividends and short-term capital gain dividends received from a RIC, to dividends with respect to taxable years of a RIC beginning before January 1, 2014.

[144] Secs. 871(k), 881(e), 1441(c)(12), and 1441(a).

Effective Date

The provision applies to dividends paid with respect to any taxable year of the RIC beginning after December 31, 2011.

21. RIC qualified investment entity treatment under FIRPTA (sec. 221 of the bill and secs. 897 and 1445 of the Code)

Present Law

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, although a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or active business requirements are met, a foreign person who sells a U.S. real property interest ("USRPI") is subject to tax at the same rates as a U.S. person, under the Foreign Investment in Real Property Tax Act ("FIRPTA") provisions codified in section 897 of the Code. Withholding tax is also imposed under section 1445.

A USRPI includes stock or a beneficial interest in any domestic corporation unless such corporation has not been a U.S. real property holding corporation (as defined) during the testing period. A USRPI does not include an interest in a domestically controlled "qualified investment entity." A distribution from a "qualified investment entity" that is attributable to the sale of a USRPI is also subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United States and the recipient foreign corporation or nonresident alien individual did not hold more than five percent of that class of stock or beneficial interest within the one-year period ending on the date of distribution.[145] Special rules apply to situations involving tiers of qualified investment entities.

The term "qualified investment entity" includes a real estate investment trust ("REIT") and also includes a regulated investment company ("RIC") that meets certain requirements, although the inclusion of a RIC in that definition does not apply for certain purposes after December 31, 2011.[146]

Reasons for Change

The Committee believes it is desirable to extend the provision for an additional two years.

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[145] Sections 857(b)(3)(F), 852(b)(3)(E), and 871(k)(2)(E) require dividend treatment, rather than capital gain treatment, for certain distributions to which FIRPTA does not apply by reason of this exception. See also section 881(e)(2).

[146] Section 897(h).

Explanation of Provision

The provision extends the inclusion of a RIC within the definition of a "qualified investment entity" under section 897 through December 31, 2013, for those situations in which that inclusion would otherwise have expired at the end of 2011.

Effective Date

The provision is generally effective on January 1, 2012.

The provision does not apply with respect to the withholding requirement under section 1445 for any payment made before the date of enactment, but a RIC that withheld and remitted tax under section 1445 on distributions made after December 31, 2011 and before the date of enactment is not liable to the distributee with respect to such withheld and remitted amounts.

22. Exceptions for active financing income (sec. 222 of the bill and secs. 953 and 954 of the Code)

Present Law

Under the subpart F rules,[147] 10-percent-or-greater 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 real estate mortgage investment conduits ("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

[147] Secs. 951-964.

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.[148]

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, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").

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 active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the 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 a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also 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

[148] Prop. Treas. Reg. sec. 1.953-1(a).

insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also 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.

Reasons for Change

The Committee believes that it is appropriate to extend the temporary provisions for an additional two years to provide certainty and to allow for business planning.

Explanation of Provision

The provision extends for two years (for taxable years beginning before 2014) the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2011, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

23. Look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules (sec. 223 of the bill and sec. 954(c)(6) of the Code)

Present Law

In general

The rules of subpart F[149] 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

[149] Secs. 951-964.

personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, 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. In addition, subpart F income of a CFC does not include any item of income from sources within the United States that is effectively connected with the conduct by such CFC of a trade or business within the United States ("ECI") unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

The "look-thru rule"

Under the "look-thru rule" (sec. 954(c)(6)), dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), 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 income of the payor that is neither subpart F income nor treated as ECI. 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 CFC's stock (by vote or value) constitutes control for these purposes.

The Secretary is authorized to prescribe regulations that are necessary or appropriate to carry out the look-thru rule, including such regulations as are appropriate to prevent the abuse of the purposes of such rule.

The look-thru rule is effective for taxable years of foreign corporations beginning before January 1, 2012, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Reasons for Change

The Committee believes that it is appropriate to extend the look-through provision for an additional two years[150] in order to assist the competitiveness of U.S. companies with overseas operations.

[150] The provision was originally enacted in the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109-222), for taxable years beginning before January 1, 2009, and extended for one year in the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Div. C of Pub. L. No. 110-343). It was most recently extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312) through December 31, 2011.

Explanation of Provision

The provision extends for two years the application of the look-thru rule, to taxable years of foreign corporations ending before January 1, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2011, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

24. Exclusion of 100 percent of gain on certain small business stock (sec. 224 of the bill and sec. 1202 of the Code)

Present Law

In general

A taxpayer other than a corporation may exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years.[151] The amount of gain eligible for the exclusion by an individual with respect to the stock of any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) $10 million (reduced by the amount of gain eligible for exclusion in prior years). To qualify as a small business, when the stock is issued, the aggregate gross assets (*i.e.*, cash plus aggregate adjusted basis of other property) held by the corporation may not exceed $50 million. The corporation also must meet certain active trade or business requirements.

The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax.[152] A percentage of the excluded gain is an alternative minimum tax preference;[153] the portion of the gain includible in alternative minimum taxable income is taxed at a maximum rate of 28 percent under the alternative minimum tax.

Gain from the sale of qualified small business stock generally is taxed at effective rates of 14 percent under the regular tax[154] and (i) 14.98 percent under the alternative minimum tax for

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[151] Sec. 1202.

[152] Sec. 1(h).

[153] Sec. 57(a)(7). In the case of qualified small business stock, the percentage of gain excluded from gross income which is an alternative minimum tax preference is (i) seven percent in the case of stock disposed of in a taxable year beginning before 2013; (ii) 42 percent in the case of stock acquired before January 1, 2001, and disposed of in a taxable year beginning after 2012; and (iii) 28 percent in the case of stock acquired after December 31, 2000, and disposed of in a taxable year beginning after 2012.

[154] The 50 percent of gain included in taxable income is taxed at a maximum rate of 28 percent.

dispositions in a taxable year beginning before January 1, 2013; (ii) 19.88 percent under the alternative minimum tax for dispositions in a taxable year beginning after December 31, 2012, in the case of stock acquired before January 1, 2001; and (iii) 17.92 percent under the alternative minimum tax for dispositions in a taxable year beginning after December 31, 2012, in the case of stock acquired after December 31, 2000.[155]

Special rules for certain stock issued in 2009, 2010, and 2011

For stock issued after February 17, 2009, and before September 28, 2010, the percentage exclusion for qualified small business stock sold by an individual is increased to 75 percent.

As a result of the increased exclusion, gain from the sale of qualified small business stock to which the provision applies is taxed at maximum effective rates of seven percent under the regular tax[156] and 12.88 percent under the AMT.[157]

For stock issued after September 27, 2010, and before January 1, 2012, the percentage exclusion for qualified small business stock sold by an individual is increased to 100 percent and the minimum tax preference does not apply.

Rollover of gain

An individual may elect to rollover gain from the sale of qualified small business stock held more than six months where other qualified small business stock is purchased during the 60-day period beginning on the date of sale.[158] The holding period for the replacement stock includes the period the original stock was held.[159]

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[155] The amount of gain included in alternative minimum tax is taxed at a maximum rate of 28 percent. The amount so included is the sum of (i) 50 percent (the percentage included in taxable income) of the total gain and (ii) the applicable preference percentage of the one-half gain that is excluded from taxable income.

[156] The 25 percent of gain included in taxable income is taxed at a maximum rate of 28 percent.

[157] The 46 percent of gain included in AMTI is taxed at a maximum rate of 28 percent. Forty-six percent is the sum of 25 percent (the percentage of total gain included in taxable income) plus 21 percent (the percentage of total gain which is an alternative minimum tax preference).

[158] Sec. 1045.

[159] Sec. 1223(13). Under present law, it is unclear whether the tacked-holding–period applies for purposes of determining when the replacement stock was acquired for purposes of determining the exclusion percentage. One commentator has suggested "it appears that 1223(13)'s tacked-holding-period should apply for this latter purpose [*i.e.*, determining the date the replacement stock was acquired] as well." Ginsburg, Levin, and Rocap, *Mergers, Acquisitions, and Buyouts*, p. 2-399 (Feb. 2012).

Reasons for Change

The Committee believes that extending the increased exclusion and the elimination of the minimum tax preference for small business stock gain will encourage and reward investment in qualified small business stock.

Explanation of Provision

The provision extends the 100-percent exclusion and the exception from minimum tax preference treatment for two years (for stock acquired before January 1, 2014).

The provision clarifies that in the case of any stock acquired (determined without regard to the tacked-holding period) after February 17, 2009, and before January 1, 2014, the date of acquisition for purposes of determining the exclusion percentage is the date the holding period for the stock begins. Thus, for example, if an individual (i) acquires qualified small business stock at its original issue for $1 million on July 1, 2006, (ii) sells the stock on March 1, 2012, for $2 million in a transaction in which gain is not recognized by reason of section 1045, (iii) acquires qualified replacement stock at its original issue on March 15, 2012, for $2 million, and (iv) sells the replacement stock for $3 million, 50 percent of the $2 million gain on the sale of the replacement stock is excluded from gross income.[160]

Effective Date

The provision is generally effective for stock acquired after December 31, 2011.

The clarification applies to stock acquired after February 17, 2009.

25. Basis adjustment to stock of S corporations making charitable contributions of property (sec. 225 of the bill and sec. 1367 of the Code)

Present Law

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.[161] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[162]

In the case of contributions made in taxable years beginning before January 1, 2012, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a

[160] This example assumes all the requirements of section 1202 are met with respect to the original stock and the replacement stock.

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

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

charitable contribution made by the corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For contributions made in taxable years beginning after December 31, 2011, the amount of the reduction is the shareholder's pro rata share of the fair market value of the contributed property.

Reasons for Change

The Committee believes that the treatment of contributions of property by S corporations that applied to contributions made in certain taxable years beginning before January 1, 2012, is appropriate and should be extended.

Explanation of Provision

The provision extends the rule relating to the basis reduction on account of charitable contributions of property for two years to contributions made in taxable years beginning before January 1, 2014.

Effective Date

The provision applies to contributions made in taxable years beginning after December 31, 2011.

26. Reduction in recognition period for S corporation built-in gains tax (sec. 226 of the bill and sec. 1374 of the Code)

Present Law

A "small business corporation" (as defined in section 1361(b)) may elect to be treated as an S corporation. Unlike C corporations, S corporations generally pay no corporate-level tax. Instead, items of income and loss of an S corporation pass through to its shareholders. Each shareholder takes into account separately its share of these items on its individual income tax return.[163]

Under section 1374, a corporate level built-in gains tax, at the highest marginal rate applicable to corporations (currently 35 percent), is imposed on an S corporation's net recognized built-in gain[164] that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period, *i.e.*, the 10-year period beginning with the first day of the first taxable year for which the S election is in effect.[165]

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[163] Sec. 1366.

[164] Certain built-in income items are treated as recognized built-in gain for this purpose. Sec. 1374(d)(5).

[165] Sec. 1374(d)(7)(A). The 10-year period refers to ten calendar years from the first day of the first taxable year for which the corporation was an S corporation. A regulated investment company (RIC) or a real estate investment trust (REIT) that was formerly a C corporation (or that acquired assets from a C corporation) may elect to be subject to the rules of section 1374 "as if the RIC or REIT were an S corporation." Treas. Reg. sec. 1.337(d)-7(b)(1).

If the taxable income of the S corporation is less than the amount of net recognized built-in gain in the year such built-in gain is recognized (for example, because of post- conversion losses), no tax under section 1374 is imposed on the excess of such built-in gain over taxable income for that year. However the untaxed excess of net recognized built-in gain over taxable income for that year is treated as recognized built-in gain in the succeeding taxable year.[166] Treasury regulations provide that if a corporation sells an asset before or during the recognition period and reports the income from the sale using the installment method under section 453 during or after the recognition period, that income is subject to tax under section 1374.[167]

Under a temporary rule, for any taxable year beginning in 2009 and 2010, no tax was imposed on an S corporation under section 1374 if the seventh taxable year in the corporation's recognition period preceded such taxable year.[168] Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, for taxable years beginning in 2009 and 2010, no tax was imposed under section 1374 after the seventh taxable year the S corporation election was in effect. For any taxable year beginning in 2011, a similar rule applied, substituting 5 years for 7 years.

The built-in gain tax also applies to net recognized built-in gain attributable to any asset received by an S corporation from a C corporation in a transaction in which the S corporation's basis in the asset is determined (in whole or in part) by reference to the basis of such asset (or other property) in the hands of the C corporation.[169] In the case of built-in gain attributable to an asset received by an S corporation from a C corporation in such a transaction, the recognition period rules are applied by substituting the date such asset was acquired by the S corporation in lieu of the beginning of the first taxable year for which the corporation was an S corporation.[170]

The amount of the built-in gain tax under section 1374 is treated as a loss taken into account by the shareholders in computing their individual income tax.[171]

Reasons for Change

The Committee believes it is desirable to continue to provide a shortened period for purposes of the built-in gain tax, for an additional 2 years. The bill also makes technical changes to insure the provision operates as intended.

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[166] Sec. 1374(d)(2).

[167] Treas. Reg. sec. 1.1374-4(h).

[168] Sec. 1374(d)(7)(B).

[169] Sec. 1374(d)(8). With respect to such assets, the recognition period runs from the day on which such assets were acquired (in lieu of the beginning of the first taxable year for which the corporation was an S corporation). Sec. 1374(d)(8)(B).

[170] Shareholders continue to take into account all items of gain and loss under section 1366.

[171] Sec. 1366(f)(2).

Explanation of Provision

For dispositions of property in taxable years beginning in 2012 and 2013, the provision applies the term "recognition period" in section 1374, for purposes of computing the built-in gain tax, by substituting a five-year period[172] for the otherwise applicable 10-year period. Thus, for such dispositions, the recognition period is the 5-year period beginning with the first day of the first taxable year for which the corporation was an S corporation (or beginning with the date of acquisition of assets if the rules applicable to assets acquired from a C corporation apply). Thus, in the case of a C corporation that elects S status, if property is disposed of in a taxable year beginning in 2012 or 2013 more than five years after the first day of the first taxable year the corporation was an S corporation, gain or loss on the disposition will not be taken into account in computing the net recognized built-in gain.

A technical amendment, addressing the temporary period of the new rule, provides that the rule requiring the excess of net recognized built-in gain over taxable income for a taxable year to be carried forward and treated as recognized built-in gain in the succeeding taxable year applies only to gain recognized within the recognition period. Thus, for example, built-in gain recognized in a taxable year beginning in 2013, from a disposition in that year that occurs beyond the end of the temporary 5-year recognition period, will not be carried forward under the income limitation rule and treated as recognized built-in gain in the taxable year beginning in 2014 (after the temporary provision has expired and the recognition period is again 10 years).

It is intended that under the provision Treasury regulations providing for the treatment of installment sales (as well as other Treasury regulations under section 1374) will continue to apply for taxable years beginning in 2012 and 2013 in the same manner as under the law in effect for taxable years beginning prior to 2009, but applying the temporary 5-year recognition period in place of the 10-year recognition period in the case of dispositions of property during the temporary period. Thus, for example, if a corporation sold an asset in 2008 in a sale occurring on or before the recognition period in effect at that time, and reported the gain using the installment method under section 453, gain recognized under that method in 2012 or 2013 (including, for example, any gain under section 453B from a disposition of the installment obligation in those years)[173] is subject to 1374 tax. On the other hand, if a corporation sold an asset in a taxable year beginning in 2012 or 2013, and the sale occurred beyond the end of the then-effective 5-year recognition period (but not beyond the end of the otherwise applicable 10-year recognition period), then gain reported using the installment method under section 453 in a taxable year beginning in 2014 (after the temporary provision expires) is not subject to tax under section 1374, because the sale was made after the end of the recognition period applicable to that sale.

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[172] The five-year period refers to five calendar years from the first day of the first taxable year for which the corporation was an S corporation.

[173] Section 453B requires gain or loss to be recognized on disposition of an installment obligation and treated as gain or loss resulting from the sale or exchange of the property in respect of which the installment obligation was received.

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

27. Empowerment zone tax incentives (sec. 227 of the bill and secs. 1202 and 1391 of the Code)

Present Law

The Omnibus Budget Reconciliation Act of 1993 ("OBRA 93")[174] authorized the designation of nine empowerment zones ("Round I empowerment zones") to provide tax incentives for businesses to locate within certain targeted areas[175] designated by the Secretaries of the Department of Housing and Urban Development ("HUD") and the U.S Department of Agriculture ("USDA"). The Taxpayer Relief Act of 1997[176] authorized the designation of two additional Round I urban empowerment zones, and 20 additional empowerment zones ("Round II empowerment zones"). The Community Renewal Tax Relief Act of 2000 ("2000 Community Renewal Act")[177] authorized a total of ten new empowerment zones ("Round III empowerment zones"), bringing the total number of authorized empowerment zones to 40.[178] In addition, the 2000 Community Renewal Act conformed the tax incentives that are available to businesses in the Round I, Round II, and Round III empowerment zones, and extended the empowerment zone incentives through December 31, 2009.[179] The Tax Relief, Unemployment Insurance

[174] Pub. L. No. 103-66.

[175] The targeted areas are those that have pervasive poverty, high unemployment, and general economic distress, and that satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations.

[176] Pub. L. No. 105-34.

[177] Pub. L. No. 106-554.

[178] The urban part of the program is administered by the HUD and the rural part of the program is administered by the USDA. The eight Round I urban empowerment zones are Atlanta, GA; Baltimore, MD, Chicago, IL; Cleveland, OH; Detroit, MI; Los Angeles, CA; New York, NY; and Philadelphia, PA/Camden, NJ. Atlanta relinquished its empowerment zone designation in Round III. The three Round I rural empowerment zones are Kentucky Highlands, KY; Mid-Delta, MI; and Rio Grande Valley, TX. The 15 Round II urban empowerment zones are Boston, MA; Cincinnati, OH; Columbia, SC; Columbus, OH; Cumberland County, NJ; El Paso, TX; Gary/Hammond/East Chicago, IN; Ironton, OH/Huntington, WV; Knoxville, TN; Miami/Dade County, FL; Minneapolis, MN; New Haven, CT; Norfolk/Portsmouth, VA; Santa Ana, CA; and St. Louis, Missouri/East St. Louis, IL. The five Round II rural empowerment zones are Desert Communities, CA; Griggs-Steele, ND; Oglala Sioux Tribe, SD; Southernmost Illinois Delta, IL; and Southwest Georgia United, GA. The eight Round III urban empowerment zones are Fresno, CA; Jacksonville, FL; Oklahoma City, OK; Pulaski County, AR; San Antonio, TX; Syracuse, NY; Tucson, AZ; and Yonkers, NY. The two Round III rural empowerment zones are Aroostook County, ME; and Futuro, TX.

[179] If an empowerment zone designation were terminated prior to December 31, 2009, the tax incentives would cease to be available as of the termination date.

Reauthorization, and Job Creation Act of 2010 extended the empowerment zone incentives through December 31, 2011.[180]

The tax incentives available within the designated empowerment zones include a Federal income tax credit for employers who hire qualifying employees, accelerated depreciation deductions on qualifying equipment, tax-exempt bond financing, deferral of capital gains tax on sale of qualified assets sold and replaced, and partial exclusion of capital gains tax on certain sales of qualified small business stock.

The following is a description of the tax incentives.

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 empowerment zone, and (2) performs substantially all employment services within the empowerment zone in a trade or business of the employer.[181]

The wage credit rate applies to qualifying wages paid before January 1, 2012. 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 empowerment zone may claim the wage credit, regardless of whether the employer meets the definition of an "enterprise zone business."[182]

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[183] 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.[184] In addition, the $15,000 cap is reduced by any wages taken into account in computing the work opportunity tax

[180] Pub. L. No. 111-312.

[181] Sec. 1396. The $15,000 limit is annual, not cumulative such that the limit is the first $15,000 of wages paid in a calendar year which ends with or within the taxable year.

[182] Secs. 1397C(b) and 1397C(c). However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B), including a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, or liquor store, 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.

[183] Sec. 280C(a).

[184] Secs. 1396(c)(3)(A) and 51A(d)(2).

credit or the welfare-to-work credit.[185] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[186]

Increased section 179 expensing limitation

An enterprise zone business is allowed an additional $35,000 of section 179 expensing (for a total of up to $535,000 in 2010 and 2011)[187] for qualified zone property placed in service before January 1, 2012.[188] 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 $2,000,000.[189] The term "qualified zone property" is defined as depreciable tangible property (including buildings) provided that (i) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (ii) the original use of the property in an empowerment zone commences with the taxpayer, and (iii) substantially all of the use of the property is in an empowerment zone in the active conduct of a trade or business by the taxpayer. Special rules are provided in the case of property that is substantially renovated by the taxpayer.

An enterprise zone business means any qualified business entity and any qualified proprietorship. A qualified business entity means, any corporation or partnership if for such year: (1) every trade or business of such entity is the active conduct of a qualified business within an empowerment zone; (2) at least 50 percent of the total gross income of such entity is derived from the active conduct of such business; (3) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within an empowerment zone; (4) a substantial portion of the intangible property of such entity is used in the active conduct of any such business; (5) a substantial portion of the services performed for such entity by its employees are performed in an empowerment zone; (6) at least 35 percent of its employees are residents of an empowerment zone; (7) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (8) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property.[190]

A qualified proprietorship is any qualified business carried on by an individual as a proprietorship if for such year: (1) at least 50 percent of the total gross income of such

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[185] Secs. 1396(c)(3)(B) and 51A(d)(2).

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

[187] The Small Business Jobs Act of 2010, Pub. L. No. 111-240, sec. 2021.

[188] Secs. 1397A, 1397D.

[189] Sec. 1397A(a)(2), 179(b)(2). For 2012 the limit is $500,000. For taxable years beginning after 2012, the limit is $200,000.

[190] Sec. 1397C(b).

individual from such business is derived from the active conduct of such business in an empowerment zone; (2) a substantial portion of the use of the tangible property of such individual in such business (whether owned or leased) is within an empowerment zone; (3) a substantial portion of the intangible property of such business is used in the active conduct of such business; (4) a substantial portion of the services performed for such individual in such business by employees of such business are performed in an empowerment zone; (5) at least 35 percent of such employees are residents of an empowerment zone; (6) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (7) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to nonqualified financial property.[191]

A qualified business is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license or any business prohibited in connection with the employment credit.[192] In addition, the leasing of real property that is located within the empowerment zone is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property is not a qualified business unless at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

Expanded tax-exempt financing for certain zone facilities

States or local governments can issue enterprise zone facility bonds to raise funds to provide an enterprise zone business with qualified zone property.[193] These bonds can be used in areas designated enterprise communities as well as areas designated empowerment zones. To qualify, 95 percent (or more) of the net proceeds from the bond issue must be used to finance: (1) qualified zone property whose principal user is an enterprise zone business, and (2) certain land functionally related and subordinate to such property.

The term enterprise zone business is the same as that used for purposes of the increased section 179 deduction limitation (discussed above) with certain modifications for start-up businesses. First, a business will be treated as an enterprise zone business during a start-up period if (1) at the beginning of the period, it is reasonable to expect the business to be an enterprise zone business by the end of the start-up period, and (2) the business makes bona fide efforts to be an enterprise zone business. The start-up period is the period that ends with the start of the first tax year beginning more than two years after the later of (1) the issue date of the bond

[191] Sec. 1397C(c).

[192] Sec. 1397C(d). Excluded businesses include any private or commercial golf course, country club, massage parlor, hot tub facility, sun tan facility, racetrack, or other facility used for gambling or any store the principal business of which is the sale of alcoholic beverages for off-premises consumption. Sec. 144(c)(6).

[193] Sec. 1394.

issue financing the qualified zone property, and (2) the date this property is first placed in service (or, if earlier, the date that is three years after the issue date).[194]

Second, a business that qualifies as at the end of the start-up period must continue to qualify during a testing period that ends three tax years after the start-up period ends. After the three-year testing period, a business will continue to be treated as an enterprise zone business as long as 35 percent of its employees are residents of an empowerment zone or enterprise community.

The face amount of the bonds may not exceed $60 million for an empowerment zone in a rural area, $130 million for an empowerment zone in an urban area with zone population of less than 100,000, and $230 million for an empowerment zone in an urban area with zone population of at least 100,000.

Elective roll over of capital gain from the sale or exchange of any qualified empowerment zone asset

Taxpayers can elect to defer recognition of gain on the sale of a qualified empowerment zone asset[195] held for more than one year and replaced within 60 days by another qualified empowerment zone asset in the same zone.[196] The deferral is accomplished by reducing the basis of the replacement asset by the amount of the gain recognized on the sale of the asset.

Partial exclusion of capital gains on certain small business stock

Generally, individuals may exclude a percentage of gain from the sale of certain small business stock acquired at original issue and held at least five years.[197] For stock acquired prior to February 18, 2009, or after December 31, 2011, the percentage is generally 50 percent, except

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[194] Sec. 1394(b)(3).

[195] The term "qualified empowerment zone asset" means any property which would be a qualified community asset (as defined in section 1400F, relating to certain tax benefits for renewal communities) if in section 1400F: (i) references to empowerment zones were substituted for references to renewal communities, (ii) references to enterprise zone businesses (as defined in section 1397C) were substituted for references to renewal community businesses, and (iii) the date of the enactment of this paragraph were substituted for "December 31, 2001" each place it appears. Sec. 1397B(b)(1)(A).

A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock purchased for cash in an enterprise zone business), (2) a qualified community partnership interest (meaning a partnership interest acquired for cash in an enterprise zone business), and (3) qualified community business property (meaning tangible property originally used in a enterprise zone business by the taxpayer) that is purchased or substantially improved after the date of the enactment of this paragraph.

For the definition of "enterprise zone business," see text accompanying *supra* note 190. For the definition of "qualified business," see text accompanying *supra* note 190.

[196] Sec. 1397B.

[197] Sec. 1202.

that for empowerment zone stock the percentage is 60 percent. For stock acquired after February 17, 2009, and before January 1, 2012, a higher percentage applies to all small business stock with no additional percentage for empowerment zone stock.[198]

Other tax incentives

Other incentives not specific to empowerment zones but beneficial to these areas include the work opportunity tax credit for employers based on the first year of employment of certain targeted groups, including empowerment zone residents (up to $2,400 per employee), and qualified zone academy bonds for certain public schools located in an empowerment zone, or expected (as of the date of bond issuance) to have at least 35 percent of its students receiving free or reduced lunches.

Reasons for Change

The Committee believes that it continues to be important to provide tax incentives to individuals and businesses in empowerment zones and that it is appropriate to extend such incentives for an additional two years.

Explanation of Provision

The provision extends for two years, through December 31, 2013, the period for which the designation of an empowerment zone is in effect, thus extending for two years the empowerment zone tax incentives, including the wage credit, increased section 179 expensing for qualifying equipment, tax-exempt bond financing, and deferral of capital gains tax on sale of qualified assets replaced with other qualified assets.

The provision extends for two years, through December 31, 2018, the period for which the percentage exclusion for qualified small business stock (of a corporation which is a qualified business entity) acquired on or before February 17, 2009 is 60 percent. Gain attributable to periods after December 31, 2018 for qualified small business stock acquired on or before February 17, 2009 or after December 31, 2013 is subject to the general rule which provides for a percentage exclusion of 50 percent.

Effective Date

The provision relating to the designation of an empowerment zone and the provision relating to the exclusion of gain from the sale or exchange of qualified small business stock held for more than five years applies to periods after December 31, 2011.

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[198] Section 224 of the bill extends the higher percentage for two years (for stock acquired before January 1, 2014). For a more detailed description of the present law exclusion, see the explanation in this report to that section of the bill.

28. New York Liberty Zone tax-exempt bond financing (sec. 228 of the bill and sec. 1400L of the Code)

Present Law

An aggregate of $8 billion in tax-exempt private activity bonds is authorized for the purpose of financing the construction and repair of infrastructure in New York City ("Liberty Zone bonds"). The bonds must be issued before January 1, 2012.

Reasons for Change

The Committee believes that one additional extension will enable these bonds to be issued.

Explanation of Provision

The provision extends authority to issue Liberty Zone bonds for two years (through December 31, 2013).

Effective Date

The provision is effective for bonds issued after December 31, 2011.

29. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands (sec. 229 of the bill and sec. 7652(f) of the Code)

Present Law

A $13.50 per proof gallon[199] excise tax is imposed on distilled spirits produced in or imported into the United States.[200] The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (*e.g.*, Puerto Rico and the Virgin Islands).[201]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[202] The amount of the cover over is limited under Code section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon before January 1, 2012).

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[199] A proof gallon is a liquid gallon consisting of 50 percent alcohol. See sec. 5002(a)(10) and (11).

[200] Sec. 5001(a)(1).

[201] Secs. 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c).

[202] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[203] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[204] All of the amounts covered over are subject to the limitation.

Reasons for Change

The Committee believes that the needs of Puerto Rico and the Virgin Islands justify the extension of the cover over amount of $13.25 per gallon through December 31, 2013.

Explanation of Provision

The provision suspends for two years the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover over limitation of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2011 and before January 1, 2014. After December 31, 2013, the cover over amount reverts to $10.50 per proof gallon.

Effective Date

The provision is effective for articles brought into the United States after December 31, 2011.

30. Extension and Modification of American Samoa Economic Development Credit (sec. 230 of the bill and sec. 119 of Pub. L. No. 109-432)

Present Law

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006 is allowed a credit based on the corporation's economic activity-based limitation with respect to American Samoa. The credit is not part of the Code but is computed based on the rules of sections 30A and 936. The credit is allowed for the first six taxable years of a corporation that begin after December 31, 2005, and before January 1, 2012.

A corporation was an existing credit claimant with respect to a American Samoa if (1) the corporation was engaged in the active conduct of a trade or business within American Samoa on

[203] Sec. 7652(e)(2).

[204] Secs. 7652(a)(3), (b)(3), and (e)(1).

October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit[205] in an election in effect for its taxable year that included October 13, 1995.[206] A corporation that added 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) ceased 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 was added.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

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[205] For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b), 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable 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 investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936.

Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to 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 was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit generally expired for taxable years beginning after December 31, 2005.

[206] 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.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

The credit applies to the first six taxable years of a taxpayer which begin after December 31, 2005, and before January 1, 2012.

Reasons for Change

The Committee believes that, notwithstanding expiration of the Puerto Rico and possession tax credit for taxable years beginning after 2005, the U.S. Federal tax law should encourage economic activity in American Samoa. The Committee believes that a tax incentive for economic activity in American Samoa should be available to some domestic corporations that did not claim the possession tax credit but that a domestic corporation, whether or not an existing credit claimant, should be eligible for the incentive only if it has manufacturing income in American Samoa. Consequently, the Committee believes it is appropriate to extend and modify (in the manner described below) the American Samoa economic development credit.

Explanation of Provision

The provision extends the credit to apply to the first eight taxable years of a taxpayer beginning after December 31, 2005, and before January 1, 2014. For taxable years of a taxpayer beginning after December 31, 2011, the provision modifies the credit in two ways. First, the provision allows domestic corporations with operations in American Samoa to claim the credit even if those corporations are not existing credit claimants. Second, the credit is available to a domestic corporation (either an existing credit claimant or a new credit claimant) only if, in addition to satisfying all the present law requirements for claiming the credit, the corporation also has qualified production activities income (as defined in section 199(c) by substituting "American Samoa" for "the United States" in each place that latter term appears).

Effective Date

The provision is effective for taxable years beginning after December 31, 2011.

TITLE III − ENERGY TAX EXTENDERS

1. Credit for nonbusiness energy property (sec. 301 of the bill and sec. 25C of the Code)

Present Law

Section 25C provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes. A qualified energy efficiency improvement is any energy efficiency building envelope component (1) that meets or exceeds the prescriptive criteria for such a component established by the 2009 International Energy Conservation Code as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009 (February 17, 2009) (or, in the case of windows, skylights and doors, and metal roofs with appropriate pigmented coatings or asphalt roofs with appropriate cooling granules, meets the Energy Star program requirements); (2) that is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) that reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling and which meet the prescriptive criteria for such material or system established by the 2009 International Energy Conservation Code, as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009 (February 17, 2009); (2) exterior windows (including skylights) and doors; and (3) metal or asphalt roofs with appropriate pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain for a dwelling.

Additionally, section 25C provides specified credits for the purchase of specific energy efficient property originally placed in service by the taxpayer during the taxable year. The allowable credit for the purchase of certain property is (1) $50 for each advanced main air circulating fan, (2) $150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $300 for each item of energy efficient building property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Energy-efficient building property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which achieves the highest efficiency tier established by the Consortium for

Energy Efficiency, as in effect on January 1, 2009,[207] (3) a central air conditioner which achieves the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on Jan. 1, 2009,[208] (4) a natural gas, propane, or oil water heater which has an energy factor of at least 0.82 or thermal efficiency of at least 90 percent, and (5) biomass fuel property.

Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants), grasses, residues, and fibers.

The credit is available for property placed in service prior to January 1, 2012. The maximum credit for a taxpayer for all taxable years is $500, and no more than $200 of such credit may be attributable to expenditures on windows.

The taxpayer's basis in the property is reduced by the amount of the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, expenditures which are made from subsidized energy financing are not taken into account. The term "subsidized energy financing" means financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

Reasons for Change

The Committee believes that extending the credit for energy efficient improvements and property expenditures will encourage homeowners to make their homes more energy efficient, thus helping to reduce residential energy consumption.

Explanation of Provision

The provision extends the credit for two years, through December 31, 2013.

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[207] These standards are a seasonal energy efficiency ratio ("SEER") greater than or equal to 15, an energy efficiency ratio ("EER") greater than or equal to 12.5, and heating seasonal performance factor ("HSPF") greater than or equal to 8.5 for split heat pumps, and SEER greater than or equal to 14, EER greater than or equal to 12, and HSPF greater than or equal to 8.0 for packaged heat pumps.

[208] These standards are a SEER greater than or equal to 16 and EER greater than or equal to 13 for split systems, and SEER greater than or equal to 14 and EER greater than or equal to 12 for packaged systems.

Effective Date

The provision applies to property placed in service after December 31, 2011.

2. Alternative fuel vehicle refueling property (sec. 302 of the bill and sec. 30C of the Code)

Present Law

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer.[209] The credit may not exceed $30,000 per taxable year per location, in the case of qualified refueling property used in a trade or business and $1,000 per taxable year per location, in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel or electricity into the fuel tank or battery of a motor vehicle propelled by such fuel or electricity, but only if the storage or dispensing of the fuel or electricity is at the point of delivery into the fuel tank or battery of the motor vehicle. The original use of such property must begin with the taxpayer.

Clean-burning fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for one year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2012. In the case of hydrogen refueling property, the property must be placed in service before January 1, 2015.

[209] Sec. 30C.

Reasons for Change

The Committee believes that continuing to provide incentives for alternative fuel refueling property furthers America's environmental and energy independence goals by reducing gasoline consumption.

Explanation of Provision

The provision extends for two years (through 2013) the 30-percent credit for alternative fuel refueling property (other than hydrogen refueling property, the credit for which continues under present law through 2014).

Effective Date

The provision is effective for property placed in service after December 31, 2011.

3. Credit for electric motorcycles and three-wheeled vehicles (sec. 303 of the bill and sec. 30D of the Code)

Present Law

A 10-percent credit is available qualifying plug-in electric low-speed vehicles, motorcycles, and three-wheeled vehicles.[210] Two or three-wheeled vehicles must have a battery capacity of at least 2.5 kilowatt-hours. Other vehicles must have a battery capacity of at least 4 kilowatt-hours. The maximum credit for all qualifying vehicles is $2,500. The credit is part of the general business credit. The credit is available for vehicles acquired after February 17, 2009, and before January 1, 2012.

Reasons for Change

The Committee believes that continuing to provide incentives to electric motorcycles and three-wheeled vehicles furthers America's environmental and energy independence goals by reducing gasoline consumption.

Explanation of Provision

The provision combines the credit for electric motorcycles and three-wheeled vehicles (but not low-speed vehicles) with the section 30D credit for plug-in electric drive motor vehicles. The new credit provides the same incentives as the existing credit and expires for vehicles acquired on or before December 31, 2013.

Effective Date

The provision is effective for electric motorcycles acquired after December 31, 2011.

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[210] Sec. 30.

4. Extension and modification of cellulosic biofuel producer credit (sec. 304 of the bill and sec. 40 of the Code)

Present Law

The "cellulosic biofuel producer credit" is a nonrefundable income tax credit for each gallon of qualified cellulosic fuel production of the producer for the taxable year. The amount of the credit is generally $1.01 per gallon.[211]

"Qualified cellulosic biofuel production" is any cellulosic biofuel which is produced by the taxpayer and which is: (1) sold by the taxpayer to another person (a) for use by such other person in the production of a qualified cellulosic biofuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or (c) who sells such cellulosic biofuel at retail to another person and places such cellulosic biofuel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (1)(a), (b), or (c).

"Cellulosic biofuel" means any liquid fuel that (1) is produced in the United States and used as fuel in the United States, (2) is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis, and (3) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency ("EPA") under section 211 of the Clean Air Act. Cellulosic biofuel does not include fuels that (1) are more than four percent (determined by weight) water and sediment in any combination, (2) have an ash content of more than one percent (determined by weight), or (3) have an acid number greater than 25 ("unprocessed or excluded fuels").[212]

The cellulosic biofuel producer credit cannot be claimed unless the taxpayer is registered by the Internal Revenue Service ("IRS") as a producer of cellulosic biofuel. The IRS permits a taxpayer to register as a cellulosic biofuel producer after the cellulosic biofuel has been produced. Thus, a person may register as a cellulosic biofuel producer in 2010 for cellulosic biofuel produced in 2009 and then claim the credit.

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[211] In the case of cellulosic biofuel that is alcohol, the $1.01 credit amount is reduced by the credit amount of the alcohol mixture credit, and for ethanol, the credit amount for small ethanol producers, as in effect at the time the cellulosic biofuel fuel is produced. The alcohol mixture credit and small ethanol producer credits expired December 31, 2011, so there is no reduction for cellulosic biofuel that is alcohol if produced after December 31, 2011.

[212] Section 40(b)(6)(e)(iii). Water content (including both free water and water in solution with dissolved solids) is determined by distillation, using for example ASTM method D95 or a similar method suitable to the specific fuel being tested. Sediment consists of solid particles that are dispersed in the liquid fuel and is determined by centrifuge or extraction using, for example, ASTM method D1796 or D473 or similar method that reports sediment content in weight percent. Ash is the residue remaining after combustion of the sample using a specified method, such as ASTM D3174 or a similar method suitable for the fuel being tested.

Cellulosic biofuel eligible for the section 40 credit is precluded from qualifying as biodiesel, renewable diesel, or alternative fuel for purposes of the applicable income tax credit, excise tax credit, or payment provisions relating to those fuels.[213]

Because it is a credit under section 40(a), the cellulosic biofuel producer credit is part of the general business credits in section 38. However, the credit can only be carried forward three taxable years after the termination of the credit. The credit is also allowable against the alternative minimum tax. Under section 87, the credit is included in gross income. The cellulosic biofuel producer credit terminates on December 31, 2012.

Reasons for Change

The Committee believes that the cellulosic biofuel producer credit is an appropriate incentive to encourage the further development of biofuels on a commercial scale and that fuels from algae should be included within the scope of the incentive. Development of such fuels on a commercial scale will assist in securing energy independence by providing diversity in fuel sources.

Explanation of Provision

The provision extends the income tax credit for cellulosic biofuel for one additional year (through December 31, 2013). The provision makes a technical drafting correction by separately restating, apart from the general section 40 termination provisions, the rule that the cellulosic biofuel producer credit may only be carried forward three years after any termination of the cellulosic biofuel producer credit.

The provision expands qualified cellulosic biofuel production to include algae-based fuel. Producers of fuel derived from cultivated algae, cyanobacteria, or lemna will qualify for the cellulosic biofuel producer credit, a $1.01 income tax credit for each gallon of qualified cellulosic biofuel production. In addition, for algae-based fuel, the proposal expands qualified cellulosic biofuel production to include fuel derived from algae that is sold by the taxpayer to another person for refining by such other person into a fuel that meets the registration requirements for fuels and fuel additives under section 211 of the Clean Air Act. Thus, algae-based fuel sold for further refining, not just as end use as a fuel, would qualify for the credit.

Effective Date

The provision generally is effective on the date of enactment. The technical drafting correction is effective as if included in section 15321(b) of the Heartland, Habitat, Harvest, and Horticulture Act of 2008.

[213] See secs. 40A(d)(1), 40A(f)(3), and 6426(h).

5. Incentives for biodiesel and renewable diesel (sec. 305 of the bill and secs. 40A, 6426, and 6427 of the Code)

Present Law

Biodiesel

The Code provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[214] The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The amount of the biodiesel fuels credit is includible in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit does not apply to fuel sold or used after December 31, 2011.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the EPA under section 211 of the Clean Air Act (42 U.S.C. sec. 7545) and (2) the requirements of the American Society of Testing and Materials ("ASTM") D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, camelina, or animal fats.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer or importer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.

Biodiesel mixture credit

The biodiesel mixture credit is $1.00 for each gallon of biodiesel (including agri-biodiesel) used by the taxpayer in the production of a qualified biodiesel mixture. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing such mixture. The sale or use must be in the trade or business of the taxpayer and is to be taken into account for the taxable year in which such sale or use occurs. No credit is allowed with respect to any casual off-farm production of a qualified biodiesel mixture.

Per IRS guidance a mixture need only contain 1/10th of one percent of diesel fuel to be a qualified mixture.[215] Thus, a qualified biodiesel mixture can contain 99.9 percent biodiesel and 0.1 percent diesel fuel.

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[214] Sec. 40A.

[215] Notice 2005-62, I.R.B. 2005-35, 443 (2005). "A biodiesel mixture is a mixture of biodiesel and diesel fuel containing at least 0.1 percent (by volume) of diesel fuel. Thus, for example, a mixture of 999 gallons of biodiesel and 1 gallon of diesel fuel is a biodiesel mixture."

Biodiesel credit (B-100)

The biodiesel credit is $1.00 for each gallon of biodiesel that is not in a mixture with diesel fuel (100 percent biodiesel or B-100) and which during the taxable year is (1) used by the taxpayer as a fuel in a trade or business or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle.

Small agri-biodiesel producer credit

The Code provides a small agri-biodiesel producer income tax credit, in addition to the biodiesel and biodiesel mixture credits. The credit is 10 cents per gallon for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year. The agri-biodiesel must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified biodiesel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such agri-biodiesel at retail to another person and places such agri-biodiesel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[216] The credit is $1.00 for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. A biodiesel mixture is a mixture of biodiesel and diesel fuel that (1) is sold by the taxpayer producing such mixture to any person for use as a fuel or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.[217]

The credit is not available for any sale or use for any period after December 31, 2011. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

Payments with respect to biodiesel fuel mixtures

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit.[218] The biodiesel fuel mixture credit must first be taken against tax liability for taxable fuels. To the extent the biodiesel fuel mixture credit exceeds such tax liability, the excess may be received as a payment. Thus, if the person has no section 4081 liability, the credit is refundable. The Secretary is not

[216] Sec. 6426(c).

[217] Sec. 6426(c)(4).

[218] Sec. 6427(e).

required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2011.

Renewable diesel

"Renewable diesel" is liquid fuel that (1) is derived from biomass (as defined in section 45K(c)(3)), (2) meets the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act, and (3) meets the requirements of the ASTM D975 or D396, or equivalent standard established by the Secretary. ASTM D975 provides standards for diesel fuel suitable for use in diesel engines. ASTM D396 provides standards for fuel oil intended for use in fuel-oil burning equipment, such as furnaces. Renewable diesel also includes fuel derived from biomass that meets the requirements of a Department of Defense specification for military jet fuel or an ASTM specification for aviation turbine fuel.

For purposes of the Code, renewable diesel is generally treated the same as biodiesel. In the case of renewable diesel that is aviation fuel, kerosene is treated as though it were diesel fuel for purposes of a qualified renewable diesel mixture. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.[219] The incentive for renewable diesel is $1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expire after December 31, 2011.

Reasons for Change

The Committee believes that extending the biodiesel and renewable diesel incentives through 2013 will give the industry certainty and allow for business planning.

Explanation of Provision

The provision extends the income tax credit, excise tax credit and payment provisions for biodiesel and renewable diesel for two years (through December 31, 2013).

Effective Date

The provision is effective for sales and uses after December 31, 2011.

6. Credit for the production of Indian coal (sec. 306 of the bill and sec. 45 of the Code)

Present Law

A credit is available for the production of Indian coal sold to an unrelated third party from a qualified facility for a seven-year period beginning January 1, 2006, and ending December 31, 2012. The amount of the credit for Indian coal is $1.50 per ton for the first four years of the seven-year period and $2.00 per ton for the last three years of the seven-year period.

[219] Secs. 40A(f), 6426(c), and 6427(e).

Beginning in calendar years after 2006, the credit amounts are indexed annually for inflation using 2005 as the base year. The credit amount for 2012 is $2.267 per ton.

A qualified Indian coal facility is a facility placed in service before January 1, 2009, that produces coal from reserves that on June 14, 2005, were owned by a Federally recognized tribe of Indians or were held in trust by the United States for a tribe or its members.

The credit is a component of the general business credit,[220] allowing excess credits to be carried back one year and forward up to 20 years. The credit is also subject to the alternative minimum tax.

Reasons for Change

The Committee believes that extending the credit for Indian coal will encourage continued mining of coal resources on Indian lands.

Explanation of Provision

The provision extends the credit for the production of Indian coal for 1 year (through December 31, 2013). The placed-in-service date for qualified facilities is not extended.

Effective Date

The provision is effective for Indian coal produced after December 31, 2012.

7. Extension and modification of incentives for renewable electricity property (sec. 307 of the bill and secs. 45 and 48 of the Code)

Present Law

Renewable electricity production credit

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the "renewable electricity production credit").[221] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

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[220] Sec. 38(b)(8).

[221] Sec. 45. In addition to the renewable electricity production credit, section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

Summary of Credit for Electricity Produced from Certain Renewable Resources		
Eligible electricity production activity (sec. 45)	**Credit amount for 2012[1] (cents per kilowatt-hour)**	**Expiration[2]**
Wind	2.2	December 31, 2012
Closed-loop biomass	2.2	December 31, 2013
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1.1	December 31, 2013
Geothermal	2.2	December 31, 2013
Solar (pre-2006 facilities only)	2.2	December 31, 2005
Small irrigation power	1.1	December 31, 2013
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1.1	December 31, 2013
Qualified hydropower	1.1	December 31, 2013
Marine and hydrokinetic	1.1	December 31, 2013

[1] In general, the credit is available for electricity produced during the first 10 years after a facility has been placed in service.

[2] Expires for property placed in service after this date.

Municipal solid waste

One feedstock that can be used to generate credit-eligible renewable electricity is municipal solid waste. For this purpose, the term "municipal solid waste" has the meaning given the term "solid waste" under section 2(27) of the Solid Waste Disposal Act.[222] Under that Act, the term "solid waste" generally means any garbage, refuse, or sludge from a waste treatment plant, water supply treatment plant, or air pollution control facility and other discarded material, including solid, liquid, semisolid, or contained gaseous material resulting from industrial, commercial, mining, and agricultural operations, and from community activities, but does not include solid or dissolved material in domestic sewage, or solid or dissolved materials in irrigation return flows or industrial discharges.

[222] Sec. 45(c)(6).

Election to claim energy credit in lieu of renewable electricity production credit

A taxpayer may make an irrevocable election to have certain property which is part of a qualified renewable electricity production facility be treated as energy property eligible for a 30 percent investment credit under section 48. For this purpose, qualified facilities are facilities otherwise eligible for the renewable electricity production credit with respect to which no credit under section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the renewable electricity production credit. The eligible basis for the investment credit for taxpayers making this election is the basis of the depreciable (or amortizable) property that is part of a facility capable of generating electricity eligible for the renewable electricity production credit.

Reasons for Change

The Committee believes that building additional renewable energy infrastructure advances America's environmental and energy independence goals. The Committee believes that additional renewable energy infrastructure will be built if the tax incentives for renewable energy are extended. The Committee also believes that certain renewable power projects do not move forward because developers and investors are concerned that those projects cannot be completed before the renewable electricity production credit expires. The Committee intends to reduce this uncertainty by replacing the placed-in-service expiration date with an expiration date based on when construction begins on a particular project. Finally, the Committee is concerned that recyclable paper that has been segregated from the municipal solid waste stream may be diverted to trash combustion facilities. The Committee seeks to prevent this from happening by modifying the definition of municipal solid waste to exclude such paper.

Explanation of Provision

The provision extends and modifies the expiration dates for the renewable electricity production credit and the 30-percent investment credit in lieu of such production credit. The provision extends the wind credits (production and investment) for one year, through December 31, 2013. In addition, the expiration date for all renewable power facilities (including wind facilities) is modified such that qualified facilities or property will be eligible for the renewable electricity production credit, or the investment credit in lieu of such credit, if the construction of such facilities or property begins before January 1, 2014.

The provision also modifies the definition of municipal solid waste to exclude commonly recycled paper that has been segregated from such waste for purposes of this credit.

Effective Date

The provision is effective on the date of enactment.

8. New energy efficient home credit (sec. 308 of the bill and sec. 45L of the Code)

Present Law

Present law provides a credit to an eligible contractor for each qualified new energy-efficient home that is constructed by the eligible contractor and acquired by a person from such eligible contractor for use as a residence during the taxable year. To qualify as a new energy-efficient home, the home must be: (1) a dwelling located in the United States, (2) substantially completed after August 8, 2005, and (3) certified in accordance with guidance prescribed by the Secretary to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30-percent or 50-percent reduction in energy usage, compared to a comparable dwelling constructed in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on August 8, 2005, and any applicable Federal minimum efficiency standards for equipment. With respect to homes that meet the 30-percent standard, one-third of such 30-percent savings must come from the building envelope, and with respect to homes that meet the 50-percent standard, one-fifth of such 50-percent savings must come from the building envelope.

Manufactured homes that conform to Federal manufactured home construction and safety standards are eligible for the credit provided all the criteria for the credit are met. The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home.

The credit equals $1,000 in the case of a new home that meets the 30-percent standard and $2,000 in the case of a new home that meets the 50-percent standard. Only manufactured homes are eligible for the $1,000 credit.

In lieu of meeting the standards of chapter 4 of the 2003 International Energy Conservation Code, manufactured homes certified by a method prescribed by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program are eligible for the $1,000 credit provided criteria (1) and (2), above, are met.

The credit applies to homes that are purchased prior to January 1, 2012. The credit is part of the general business credit.

Reasons for Change

The Committee believes that extending the credit for energy efficient new homes will provide incentives for contractors and home manufacturers to produce such housing, thus helping to reduce residential energy consumption.

Explanation of Provision

The provision extends the credit to homes that are acquired prior to January 1, 2014.

Effective Date

The provision applies to homes acquired after December 31, 2011.

9. Energy efficient appliance credit (sec. 309 of the bill and sec. 45M of the Code)

Present Law

In general

A credit is allowed for the eligible production of certain energy-efficient dishwashers, clothes washers, and refrigerators. The credit is part of the general business credit.

The credits are as follows:

Dishwashers

$45 in the case of a dishwasher that is manufactured in calendar year 2008 or 2009 that uses no more than 324 kilowatt hours per year and 5.8 gallons per cycle, and

$75 in the case of a dishwasher that is manufactured in calendar year 2008, 2009, or 2010 and that uses no more than 307 kilowatt hours per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings).

$25 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 307 kilowatt hours per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings),

$50 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 295 kilowatt hours per year and 4.25 gallons per cycle (4.75 gallons per cycle for dishwashers designed for greater than 12 place settings), and

$75 in the case of a dishwasher which is manufactured in calendar year 2011 and which uses no more than 280 kilowatt hours per year and 4 gallons per cycle (4.5 gallons per cycle for dishwashers designed for greater than 12 place settings).

Clothes washers

$75 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 that meets or exceeds a 1.72 modified energy factor and does not exceed a 8.0 water consumption factor, and

$125 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 or 2009 that meets or exceeds a 1.8 modified energy factor and does not exceed a 7.5 water consumption factor,

$150 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 that meets or exceeds a 2.0 modified energy factor and does not exceed a 6.0 water consumption factor, and

$250 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 that meets or exceeds a 2.2 modified energy factor and does not exceed a 4.5 water consumption factor.

$175 in the case of a top-loading clothes washer manufactured in calendar year 2011 which meets or exceeds a 2.2 modified energy factor and does not exceed a 4.5 water consumption factor, and

$225 in the case of a clothes washer manufactured in calendar year 2011 which (1) is a top-loading clothes washer and which meets or exceeds a 2.4 modified energy factor and does not exceed a 4.2 water consumption factor, or (2) is a front-loading clothes washer and which meets or exceeds a 2.8 modified energy factor and does not exceed a 3.5 water consumption factor.

Refrigerators

$50 in the case of a refrigerator manufactured in calendar year 2008 that consumes at least 20 percent but not more than 22.9 percent less kilowatt hours per year than the 2001 energy conservation standards,

$75 in the case of a refrigerator that is manufactured in calendar year 2008 or 2009 that consumes at least 23 percent but not more than 24.9 percent less kilowatt hours per year than the 2001 energy conservation standards,

$100 in the case of a refrigerator that is manufactured in calendar year 2008, 2009, or 2010 that consumes at least 25 percent but not more than 29.9 percent less kilowatt hours per year than the 2001 energy conservation standards, and

$200 in the case of a refrigerator manufactured in calendar year 2008, 2009, or 2010 that consumes at least 30 percent less energy than the 2001 energy conservation standards.

$150 in the case of a refrigerator manufactured in calendar year 2011 which consumes at least 30 percent less energy than the 2001 energy conservation standards, and

$200 in the case of a refrigerator manufactured in calendar year 2011 which consumes at least 35 percent less energy than the 2001 energy conservation standards.

Definitions

A dishwasher is any residential dishwasher subject to the energy conservation standards established by the Department of Energy. A refrigerator must be an automatic defrost refrigerator-freezer with an internal volume of at least 16.5 cubic feet to qualify for the credit. A clothes washer is any residential clothes washer, including a residential style coin operated washer, that satisfies the relevant efficiency standard.

The term “modified energy factor” means the modified energy factor established by the Department of Energy for compliance with the Federal energy conservation standard.

The term "gallons per cycle" means, with respect to a dishwasher, the amount of water, expressed in gallons, required to complete a normal cycle of a dishwasher.

The term "water consumption factor" means, with respect to a clothes washer, the quotient of the total weighted per-cycle water consumption divided by the cubic foot (or liter) capacity of the clothes washer.

Other rules

Appliances eligible for the credit include only those produced in the United States and that exceed the average amount of U.S. production from the two prior calendar years for each category of appliance. The aggregate credit amount allowed with respect to a taxpayer for all taxable years beginning after December 31, 2010, may not exceed $25 million, with the exception that the $200 refrigerator credit and the $225 clothes washer credit are not limited. Additionally, the credit allowed in a taxable year for all appliances may not exceed four percent of the average annual gross receipts of the taxpayer for the three taxable years preceding the taxable year in which the credit is determined.

Reasons for Change

The Committee believes that extending the credit for energy efficient appliances will spur their production and use, thus helping to reduce residential energy consumption.

Explanation of Provision

The provision extends the credits available for appliance production in 2011 for two additional years (through 2013), with the exception that the $25 dishwasher credit and the $175 clothes washer credit are not extended.

Effective Date

The provision applies to appliances produced after December 31, 2011.

10. Extension of special depreciation allowance for cellulosic biofuel plant property (sec. 310 of the bill and sec. 168(l) of the Code)

Present Law

Section 168(l) allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified cellulosic biofuel plant property. In order to qualify, the property generally must be placed in service before January 1, 2013.

Qualified cellulosic biofuel plant property means property used in the U.S. solely to produce cellulosic biofuel. For this purpose, cellulosic biofuel means any liquid fuel which is produced from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet the following requirements. The original use of the property must commence with the taxpayer on or after December 20, 2006. The property must be acquired by purchase (as defined under section 179(d)) by the taxpayer after December 20, 2006, and placed in service before January 1, 2013. Property does not qualify if a binding written contract for the acquisition of such property was in effect on or before December 20, 2006.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after December 20, 2006, and the property is placed in service before January 1, 2013 (and all other requirements are met). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103 is not eligible for the additional first-year depreciation deduction.[223] Recapture rules apply if the property ceases to be qualified cellulosic biofuel plant property.[224]

Property with respect to which the taxpayer has elected 50 percent expensing under section 179C is not eligible for the additional first-year depreciation deduction.[225]

Reasons for Change

The Committee acknowledges that encouraging manufacturing of biofuels in the United States is important for fostering innovative new technology, encouraging energy independence, and creating manufacturing jobs in the United States. Further, expansion of the special depreciation allowance to include property related to algae-based fuels recognizes the potential of these fuels and supports their commercial production.

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[223] Sec. 168(l)(4)(C).

[224] Sec. 168(l)(7).

[225] Sec. 168(l)(8).

Explanation of Provision

The provision extends the present law special depreciation allowance for one year, to qualified cellulosic biofuel plant property placed in service prior to January 1, 2014. The provision expands the definition of qualified cellulosic biofuel plant property to include property used in the U.S. solely to produce algae-based fuel, including fuel derived from cultivated algae, cyanobacteria, or lemna.

Effective Date

The provision to extend the placed in service date is effective for property placed in service after December 31, 2012. The provision to expand the definition of qualified cellulosic biofuel plant property is effective for property placed in service after the date of enactment.

11. Special rule for sales or dispositions to implement FERC or State electric restructuring policy for qualified electric utilities (sec. 311 of the bill and sec. 451(i) of the Code)

Present Law

A taxpayer selling property generally recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period[226] (the "reinvestment property").[227] If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by a qualified electric utility to an independent transmission company prior to January 1, 2012. A qualified electric utility is defined as an electric utility, which as of the date of the qualifying electric transmission transaction, is vertically integrated in that it is both (1) a transmitting utility (as defined in the Federal Power Act)[228] with respect to the transmission

[226] The applicable period for a taxpayer to reinvest the proceeds is the four year period beginning on the date the qualifying electric transmission transaction occurs.

[227] Sec. 451(i).

[228] 16 U.S.C. sec. 796 (23), defines "transmitting utility" as any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale.

facilities to which the election applies, and (2) an electric utility (as defined in the Federal Power Act).[229]

In general, an independent transmission company is defined as: (1) an independent transmission provider[230] approved by the Federal Energy Regulatory Commission ("FERC"); (2) a person (i) who the FERC determines under section 203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider no later than four years after the close of the taxable year in which the transaction occurs; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).

Exempt utility property is defined as: (1) property used in the trade or business of generating, transmitting, distributing, or selling electricity or producing, transmitting, distributing, or selling natural gas, or (2) stock in a controlled corporation whose principal trade or business consists of the activities described in (1). Exempt utility property does not include any property that is located outside of the United States.

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the reinvestment property may be purchased by any member of the affiliated group (in lieu of the taxpayer).

Reasons for Change

The Committee believes that the "unbundling" of electric transmission assets held by vertically integrated utilities, with the transmission assets ultimately placed under the ownership or control of independent transmission providers (or other similarly-approved operators), continues to be an important policy. To facilitate the implementation of this policy, the Committee believes it is appropriate to assist taxpayers in moving forward with industry restructuring by providing a tax deferral for gain associated with certain dispositions of electric transmission assets.

Explanation of Provision

The provision extends for two years the treatment under the present-law deferral provision to sales or dispositions by a qualified electric utility that occur prior to January 1, 2014.

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[229] 16 U.S.C. sec. 796 (22), defines "electric utility" as any person or State agency (including any municipality) which sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

[230] For example, a regional transmission organization, an independent system operator, or an independent transmission company.

Effective Date

The provision applies to dispositions after December 31, 2011.

12. Alternative fuel and alternative fuel mixtures (sec. 312 of the bill and secs. 6426 and 6427(e) of the Code)

Present Law

Fuel excise taxes

Fuel excise taxes are imposed on taxable fuel (gasoline, diesel fuel or kerosene) under section 4081. In general, these fuels are taxed when removed from a refinery, terminal rack, upon entry into the United States, or upon sale to an unregistered person. A back-up tax under section 4041 is imposed on previously untaxed fuel and alternative fuel used or sold for use as fuel in a motor vehicle or motorboat to the supply tank of a highway vehicle. In general, the rates of tax are 18.3 cents per gallon (or in the case of compressed natural gas 18.3 cents per gasoline gallon equivalent), and in the case of liquefied natural gas, and liquid fuel derived from coal or biomass, 24.3 cents per gallon.

Alternative fuel and alternative fuel mixture credits and payments

The Code provides two per-gallon excise tax credits with respect to alternative fuel: the alternative fuel credit, and the alternative fuel mixture credit. For this purpose, the term "alternative fuel" means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process ("coal-to-liquids"), compressed or liquefied gas derived from biomass, or liquid fuel derived from biomass. Such term does not include ethanol, methanol, or biodiesel.

For coal-to-liquids produced after December 30, 2009, the fuel must be certified as having been derived from coal produced at a gasification facility that separates and sequesters 75 percent of such facility's total carbon dioxide emissions.

The alternative fuel credit is allowed against section 4041 liability, and the alternative fuel mixture credit is allowed against section 4081 liability. Neither credit is allowed unless the taxpayer is registered with the Secretary. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents[231] of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat, sold for use in aviation or so used by the taxpayer.

The alternative fuel mixture credit is 50 cents per gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. An

[231] "Gasoline gallon equivalent" means, with respect to any nonliquid alternative fuel (for example, compressed natural gas), the amount of such fuel having a Btu (British thermal unit) content of 124,800 (higher heating value).

"alternative fuel mixture" is a mixture of alternative fuel and taxable fuel (gasoline, diesel fuel or kerosene) that contains at least 1/10 of one percent taxable fuel. The mixture must be sold by the taxpayer producing such mixture to any person for use as a fuel, or used by the taxpayer producing the mixture as a fuel. The credits generally expire after December 31, 2011 (September 30, 2014 for liquefied hydrogen).

A person may file a claim for payment equal to the amount of the alternative fuel credit and alternative fuel mixture credits. The alternative fuel credit and alternative fuel mixture credit must first be applied to the applicable excise tax liability under section 4041 or 4081, and any excess credit may be taken as a payment. These payment provisions generally also expire after December 31, 2011. With respect to liquefied hydrogen, the payment provisions expire after September 30, 2014.

For purposes of the alternative fuel credit, alternative fuel mixture credit and related payment provisions, "alternative fuel" does not include fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp.

Reasons for Change

The Committee believes it is appropriate to extend the incentives for alternative fuel to provide certainty to the industry and allow for business planning. It has come to the attention of the Committee that the refundable aspect of the alternative fuel mixture credit, in combination with requiring only one-tenth of one percent of diesel fuel to qualify as a mixture, has encouraged taxpayers to be aggressive in making large and questionable claims for payment.[232] Because the claims can be made weekly and are subject to interest if not paid timely, it is the understanding of the Committee that these circumstances result in the IRS often examining such claims after payment and having to recover an erroneous overpayment. If the payment cannot be recovered from the taxapayer, it results not only in administrative expenses to the Federal Government, but a loss of revenue as well. Therefore, the Committee believes that to deter abusive claims for payment, it is appropriate not to extend the outlay payments for alternative fuel mixtures.

Explanation of Provision

The provision extends the alternative fuel excise tax credit, and related payment provisions (for non-hydrogen fuels), for two additional years (through December 31, 2013). The alternative fuel mixture excise tax credit is extended for two additional years (through December 31, 2013) but the companion payment (outlay) provision is not extended.

Effective Date

The provision is effective for fuel sold or used after December 31, 2011.

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[232] For an example of aggressive claims relating to alternative fuel mixtures see IRS Chief Counsel Advice 201133010, 2011 WL 3636293 (July 12, 2011).

TITLE IV − OTHER PROVISIONS

1. Sense of the Senate that reducing tax expenditures in order to lower tax rates should be the focus of comprehensive tax reform in the 113th Congress (sec. 401 of the bill)

Present Law

Congress last enacted fundamental tax reform in the Tax Reform Act of 1986.[233]

Explanation of Provision

The provision expresses the sense of the Senate that:

- Comprehensive tax reform is vital to economic growth and U.S. competitiveness and should begin next year;
- A major focus of comprehensive tax reform should be broadening the tax base so as to lower tax rates, including by reforming, eliminating or significantly reducing tax expenditures, including traditional tax extenders; and
- Whenever possible, Federal energy tax expenditures should be responsibly phased-out in a manner that allows these technologies to function without a reliance on Federal subsidies.

Effective Date

The provision is effective upon enactment.

[233] Pub L. No. 99-514.

III. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of the "Family and Business Tax Cut Certainty Act of 2012" as reported.

[Insert revenue table]

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that no provisions of the bill as reported involve new or increased budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing provisions of the bill involve increased tax expenditures (see revenue table in Part A., above). The revenue-increasing provisions of the bill involve reduced tax expenditures (see revenue table in part A., above).

C. Consultation with Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on the bill. The letter from the Congressional Budget Office will be provided separately.

IV. VOTES OF THE COMMITTEE

Chairman's Mark, as modified, was accepted by unanimous consent.

Amendment #10, Wyden #2: Electric Motorcycle Tax Credit Parity and Extension -- approved by voice vote.

Amendment #45, Kyl #9, as modified: To strike the extension of the refundable features of the biodiesel mixture credit, the alternative fuel credit, and the alternative fuel mixture credit -- approved by voice vote

Amendment 59, Coburn #7. To strike the "Credit for Energy Efficient Appliances" (Secs. 40A, 6426 and 6427 of the Code) from the bill -- defeated by roll call vote, 9 Ayes, 15 nays.

Ayes: Hatch, Kyl, Crapo, Roberts (proxy), Enzi, Cornyn, Coburn, Thune, Burr.

Nays: Baucus, Rockefeller, Conrad, Bingaman, Kerry, Wyden (proxy), Schumer, Stabenow, Cantwell, Nelson, Menendez (proxy), Carper, Cardin, Grassley, Snowe

Amendment #115, Thune #1, as modified: To express support for Comprehensive Tax Reform -- approved by voice vote.

Amendment #20, Cantwell, Snowe, Bingaman, Cardin, Kerry, Stabenow, Menendez #2: Ensure the utilization of the low income housing tax credit at a minimum 9% rate through 2013 by amendment section 42(b)(2)(A) to replace "which is placed in service by the taxpayer" with "with respect to which an allocation is made" -- approved by voice vote.

Amendment 90, Coburn #37: To modify the section of the bill relating to Wind PTC -- defeated by roll call vote, 9 ayes, 15 nays.

Ayes: Hatch, Snowe, Kyl (proxy), Crapo (Proxy), Enzi, Cornyn (proxy), Coburn, Thune, Burr.

Nays: Baucus, Rockefeller (proxy), Conrad (proxy), Bingaman, Kerry (proxy), Wyden (proxy), Schumer (proxy), Stabenow (proxy), Cantwell, Nelson (proxy), Menendez, Carper (proxy), Cardin (proxy), Grassley, Roberts (proxy).

Amendment #96, Coburn #43: To require recipients of federal tax credits (not including individuals) and other tax benefits provided in this bill, to be included in the USAspending.gov website, as a recipient of federal funding -- defeated by roll call vote, 10 ayes, 14 nays.

Ayes: Carper, Hatch, Snowe, Kyl (proxy), Crapo, Roberts (proxy), Cornyn, Coburn, Thune, Burr.

Nays: Baucus, Rockefeller, Conrad (proxy), Bingaman, Kerry, Wyden, Schumer, Stabenow, Cantwell, Nelson (proxy), Menendez, Cardin, Grassley (proxy), Enzi (proxy).

Amendment #66, Coburn #14: To prohibit duplication in the New Markets Tax Credit -- defeated by roll call vote, 10 ayes, 14 nays.

Ayes: Hatch, Grassley (proxy), Kyl (proxy), Crapo, Roberts (proxy), Enzi (proxy), Cornyn, Coburn, Thune, Burr.

Nays: Baucus, Rockefeller, Conrad, Bingaman, Kerry, Wyden, Schumer, Stabenow, Cantwell, Nelson (proxy), Menendez, Carper, Cardin, Snowe.

Final Passage of the Family and Business Tax Cut Certainty Act of 2012 -- approved by roll call vote, 19 ayes, 5 nays.

Ayes: Baucus, Rockefeller, Conrad, Bingaman, Kerry, Wyden, Schumer, Stabenow, Cantwell, Nelson (proxy), Menendez, Carper, Cardin, Hatch, Grassley, Snowe, Crapo, Roberts (proxy), Thune.

Nays: Kyl (proxy), Enzi (proxy), Cornyn, Coburn, Burr.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as amended.

Impact on individuals and businesses, personal privacy and paperwork

The bill permanently extends the specific disclosure authority to prisons relating to tax-related misconduct. In addition, the bill: (1) authorizes the disclosure of actual returns (not just return information), (2) allows the disclosure to be made directly to officers and employees of the prison agency rather than through the head of such agency, (3) allows redisclosure of return information to contractors that operate prisons, and (4) clarifies the authority for the disclosure to, and use by, legal representatives in proceedings. The provision should not result in additional recordkeeping responsibilities for individuals and businesses beyond that required for present law. The provisions will benefit the administration of the tax system and only affects the personal privacy of prisoners.

B. Unfunded Mandates Statement

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

The Committee has determined that the tax provisions of the reported bill do not contain Federal private sector mandates or Federal intergovernmental mandates on State, local, or tribal governments within the meaning of Public Law 104-4, the Unfunded Mandates Reform Act of 1995. The costs required to comply with each Federal private sector mandate generally are no greater than the aggregate estimated budget effects of the provision.

C. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) 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 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.

1. Extension of alternative minimum tax relief for individuals

Summary description of the provision

The bill allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits for taxable years beginning in 2012 and 2013.

The bill provides that the individual AMT exemption amount for taxable years beginning in 2012 is (1) $78,750, in the case of married individuals filing a joint return and surviving spouses; (2) $50,600 in the case of other unmarried individuals; and (3) $39,375 in the case of married individuals filing separate returns. Also, the bill provides that the individual AMT exemption amount for taxable years beginning in 2013 is $79,850 for married individuals filing a joint return and surviving spouses; (2) $51,150 in the case of other unmarried individuals; and (3) $39,925 in the case of married individuals filing separate returns.

Number of affected taxpayers

It is estimated that the provision will affect approximately 30 million individual tax returns.

Discussion

Many individuals will not have to compute their alternative minimum tax and file the IRS forms relating to that tax.

INSERT IRS/TREASURY LETTER HERE

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

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

VII. DISSENTING VIEWS

Minority Views of Senators Kyl, Coburn, and Burr

We respectfully file our dissenting views to the Family and Business Tax Cut Certainty Act of 2012, which was approved by the Senate Finance Committee on August 2, 2012. We appreciate the work of the chairman, ranking member, and committee staff to develop a framework that allowed the committee process to function and move forward with the legislation. We also agree that American families and businesses deserve certainty about tax policy. To that end, we are committed to permanent, pro-growth tax reform that lowers rates, broadens the base, and makes America more competitive internationally.

However, if this legislation was intended to be a prelude to tax reform, we believe it failed by not culling enough unwarranted provisions. The tax code should not be used as a tool for picking winners and losers, nor should it reward politically favored industries or penalize disfavored ones. Among the dozens of tax provisions that expired last year or will expire this year, this package extends too many that have little to do with sound tax policy and are actually harmful, market-distorting subsidies. For example, we are concerned that the relentless dedication to subsidizing so-called "green energy" will prevent the most efficient development of energy sources and cause a loss of jobs in the broader economy.

In addition, it was our understanding that this package would only extend items that enjoyed broad consensus. We were disheartened to see provisions included that were supported only by members of one party. This continued during the amendment process, when members of the other party added back a subsidy for plug-in motorcycles that we previously believed the committee had decided to end.

We are also deeply concerned about the impact of the committee's expansion of the production tax credit for wind energy on our budget deficit. Under current law, the tax code requires that wind facilities be operating and producing energy before the provision's expiration date in order to qualify for a 10-year tax credit of 2.2 cents per kilowatt hour. According to the Joint Committee on Taxation, a straightforward extension of this provision through 2013 would have cost $3.5 billion. But since the committee changed the credit to require only that construction begin – not be completed – by 2013, this provision will now cost nearly $12.2 billion, which is more than twice as large as all the other energy provisions in the package combined. We supported Senator Coburn's amendment to reduce this subsidy by 20% in 2013, but the committee unfortunately defeated it.

For these reasons and others, we did not support the package the committee approved. As the legislative process continues, we hope our colleagues in the Senate and House of Representatives will carefully consider the wisdom of continuing market-distorting subsidies through the tax code, particularly at a time of trillion-dollar deficits.