Calendar No. 1171

96TH CONGRESS 2d Session } SENATE { REPORT No. 96–1039

DISCLOSURE OF MAILING ADDRESSES OF INDIVIDUALS WHO HAVE DEFAULTED ON CERTAIN STUDENT LOANS

REPORT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ON

H.R. 4155

NOVEMBER 25 (legislative day, NOVEMBER 20), 1980.—Ordered to be printed

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

REPORT

[To accompany H.R. 4155]

The Committee on Finance, to which was referred the act (H.R. 4155) to amend the Internal Revenue Code of 1954 to allow the Internal Revenue Service to disclose the mailing addresses of individuals who have defaulted on student loans made under the Migration and Refugee Assistance Act of 1962, having considered the same, reports favorably thereon with amendments and recommends that the act as amended do pass.

The amendments are shown in the text of the bill in italic.

House bill.—H.R. 4155, as it passed the House, authorizes the Secretary of the Treasury to disclose the mailing addresses of taxpayers who have defaulted on student loans made under the Migration and Refugee Assistance Act of 1962 and the Guaranteed Student Loan Program.

Committee bill.—The committee bill adds provisions dealing with (1) private foundation return and reporting requirements (which are similar to provisions passed by the House as section 1 of H.R. 4746, except that the effective date is delayed for one year and regulatory authority to require filing by foundation managers with third parties is deleted), (2) the deductibility of employer contributions to pensions of foreign employees, (3) transfers of proven oil and gas properties to a controlled corporation, and (4) tax credits allowable against the alternative minimum tax.

I. SUMMARY

Sec. 1. Disclosure of Mailing Addresses of Individuals Who Have Defaulted on Certain Student Loans

Present law authorizes the Secretary of the Treasury to disclose to the Secretary of Education the mailing addresses of taxpayers who have defaulted on certain student loans made under the Higher Education Act of 1965 for use in locating such taxpayers and collecting the loans. However, there is no provision for the disclosure of mailing addresses of taxpayers who have defaulted on student loans made under the Migration and Refugee Assistance Act of 1962 or under the Guaranteed Student Loan Program.

The bill expands present law to allow the Secretary to disclose the mailing addresses of taxpayers who have defaulted on student loans made under the Migration and Refugee Assistance Act of 1962 and the Guaranteed Student Loan Program.

Sec. 2. Simplification of Private Foundation Return and Reporting Requirements

This section combines information reporting requirements for private foundations so that only one return would have to be filed to furnish information now required on two separate returns. It also provides that nonexempt wholly charitable trusts would be required to report the same information and be subject to the same disclosure requirements as exempt charitable organizations. Finally, it provides that disclosure of the name and address of an indigent or needy person receiving a grant of less than $1,000 in any year need not be made.

Sec. 3. Nonqualified Deferred Compensation Plans for Nonresident Aliens

Under present law the Code provides special rules for deductions of amounts under pension and other deferred compensation plans. Separate rules apply with respect to qualified and nonqualified deferred compensation plans.

The IRS has held that if a foreign branch's plan for the benefit of nonresident alien employees did not meet all of the requirements for qualification under the Code, no deduction would be allowable under the rules for qualified plans, but amounts would be deductible, if at all, only under the rules which apply to nonqualified plans.

The bill provides that in the case of a nonqualified deferred compensation plan which is maintained for the benefit of persons substantially all of whom are nonresident aliens, the general rules regarding the timing and allowability of deductions for contributions will not apply (unless the taxpayer elects to have those rules apply to the plan). Instead, special rules for deductibility are prescribed.

Subject to limitations, the bill permits a deduction for amounts paid to a trust even though the trust did not meet all the requirements for qualification. Deductions would generally be limited to the lesser

amount deductible under foreign law or the amount allowable under standards comparable to those applied in the case of plans in the United States (but eliminating those limitations applicable to further U.S. social policy rather than U.S. tax policy). In the case of unfunded reserve plans, the deductible addition to the reserve would be the present discounted value of the current liability of the foreign subsidiary or branch, using a discount rate intended to put employers electing to use unfunded reserve plans in a position equivalent to employers electing to use funded plans.

Sec. 4. Transfers of Proven Oil and Gas Properties to a Controlled Corporation by Individuals

Under present law, independent producers and royalty owners are permitted to claim a deduction for percentage depletion with respect to a limited amount of oil or gas production. Generally, the otherwise allowable percentage depletion deduction is denied with respect to production from proven oil and gas properties which have been transferred after 1974. Such a transfer, however, generally does not preclude the deduction if the transferee and transferor must allocate one depletable quantity. Existing law contains no provision whereby an individual and his or her controlled corporation must allocate one depletable quantity in order to come within this exception.

The bill provides a limited exception to the generally applicable rules of present law which prohibit oil and gas production from being eligible for percentage depletion if the production is from a proven oil or gas property which has been transferred by an individual after December 31, 1974. Under this elective exception (which generally would not allow an increase in the aggregate amount of oil or gas production subject to percentage depletion), individuals would be allowed to transfer oil or gas properties to a controlled corporation without the loss of percentage depletion if several conditions are satisfied. Only oil or gas properties could be transferred to the corporation, and all of the corporation's outstanding stock (and no debt securities or similar obligations) would have to be issued directly to the individual transferors of the oil or gas properties solely in exchange for those properties. The corporation and the shareholders would be required to allocate one 1,000 barrel amount eligible for depletion subsequent to the transfer.

In the absence of satisfying these new rules or of an election under this provision, the rules of present law would continue to apply. Thus, production from a proven oil or gas property which has been transferred by an individual in an exchange to which section 351 applies would not be eligible for percentage depletion.

The provision applies to qualifying transfers made by individuals in taxable years ending after December 31, 1974, but only as to percentage depletion for production in periods after December 31, 1979. Therefore, the provision does not apply to oil or gas production in periods before January 1, 1980.

Sec. 5. Tax Credits Allowable Against Alternative Minimum Tax

In general, this section of the bill allows each nonrefundable tax credit to be used to offset the alternative minimum tax, except to the extent attributable to net capital gains and adjusted itemized deductions, if the credit attributable to the active conduct of a trade or business by the taxpayer.

II. EXPLANATION OF THE BILL

A. Disclosure of Mailing Addresses of Individuals Who Have Defaulted on Certain Student Loans (sec. 1 of the bill and sec. 6103 of the Code)

Present law

Under present law, the Secretary of the Treasury may disclose to the Commissioner of Education the mailing address of any taxpayer who has defaulted on a National Direct Student Loan under the fund established under part E of Title IV of the Higher Education Act of 1965 (Code sec. 6103(m)(4)). The addresses disclosed by the Secretary may be used only for the purpose of locating taxpayers who have defaulted on student loans in order to collect the defaulted amounts.

Any mailing addresses which have been disclosed to the Commissioner of Education may, in turn, be disclosed to any educational institution with which there is an agreement under this loan program. Officers, employees, or agents of such an institution, whose duties relate to the collection of student loans, may use the addresses for purposes of locating individuals who have defaulted on student loans.

Reasons for change

The committee believes that present law governing the disclosure of mailing addresses of taxpayers who have defaulted on student loans is too restrictive because it applies only with respect to student loans made under part E of Title IV of the Higher Education Act of 1965. Currently, there is no provision which allows the Secretary of Education to gain access to the mailing addresses of taxpayers who have defaulted on other types of student loans. Thus, the committee believes that the disclosure provisions should be expanded to authorize the Secretary of Education to have access to the mailing addresses of taxpayers who have defaulted on loans made under the Cuban Loan Program (the Migration and Refugee Assistance Act) and loans made under the Guaranteed Student Loan Program.

In addition, the committee is very concerned about the high default rate with respect to the various student loan programs. According to estimates from the General Accounting Office, as of fiscal year 1979, there was approximately $1.3 billion in default under the Guaranteed Student Loan Program and $.7 billion in default under the National Direct Student Loan Program. It is the committee's intention that the Internal Revenue Service and the Department of Education work closely together in an attempt to develop approaches to reduce the high rate of loan defaults that presently exist in these programs.

Explanation of provision

The provision authorizes disclosure to the Secretary of Education of the mailing address of any taxpayer who has defaulted on a loan

made pursuant to the Migration and Refugee Assistance Act of 1962 or under the Guaranteed Student Loan Program. This disclosure could be made only upon written request by the Secretary of Education to the Secretary of the Treasury or his delegate. The information disclosed could be used only by officers, employees, or agents of the Department of Education for the purpose of locating the taxpayer in order to collect the loan.

In the case of guaranteed student loans, any mailing address disclosed to the Secretary of Education could be disclosed further to any lender, or any State or nonprofit guarantee agency, which is participating under the Guaranteed Loan Program (part B of Title IV of the Higher Education Act of 1965). This further disclosure could be made only to officers, employees, or agents of the lender or guarantee agency, whose duties relate to the collection of student loans, for purposes of locating individuals who have defaulted on student loans in order to collect the loans.

Any unauthorized disclosure of information received under this provision would be punishable by a fine of up to $5,000, or imprisonment of not more than 5 years, or both.

Effective date

The provision will be effective upon enactment.

Revenue effect

This provision will not have any direct effect on budget receipts.

B. Simplification of Private Foundation Return and Reporting Requirements (sec. 2 of the bill and secs. 6033, 6034, and 6056 of the Code)

Present law

Present law requires the foundation managers of private foundations having at least $5,000 of assets to file an annual report (sec. 6056). The report (Form 990–AR) is to contain the foundation's gross income, expenses, disbursements, balance sheet, total amount of contributions and gifts received by it during the year, an itemized list of all grants or contributions made or approved, the names and addresses of the foundation managers, and a list of those foundation managers who are substantial contributors or own certain interests in businesses in which the foundation owns an interest. This report must be made available for public inspection at the principal office of the foundation (sec. 6104(d)) and is open to public inspection at the offices of the Internal Revenue Service (sec. 6104(b)). In addition, the report must be furnished to the appropriate State officials (sec. 6056(d)).

Under present law, most exempt organizations described in section 501(c)(3) of the Code (including exempt private foundations) must file an annual information return (sec. 6033). Under this provision, the return for foundations, Form 990–PF, must state items of gross income, etc., and such other information as may be required by the forms and regulations. At present, this return contains most of the information required in the annual report of the foundation managers. This annual information return also is open to public inspection at the offices of the Internal Revenue Service (sec. 6104(b)). In addition, a copy of this return must be attached to the annual report of a private foundation when the report is furnished to the appropriate State officials (Treas. Reg. sec. 1.6056–1(b)(3)). Thus, information furnished on a foundation manager's report (Form 990–AR) substantially duplicates or overlaps the return filed by the foundation (Form 990–PF) in content and availability for public inspection.

Under present law, trusts which have solely charitable beneficiaries but which are not exempt from taxation (sec. 4947(a)(1) trusts) are subject to different return and disclosure requirements from those applicable to exempt charitable trusts and organizations. A nonexempt charitable trust is not required to file an annual information return open to public inspection. Instead, this type of trust is required to file an income tax return (Form 1041) under section 6012 if its gross income for the year is at least $600 or if it has any taxable income. (Form 1041 need not be filed by a nonexempt charitable trust which is a private foundation and which has no taxable income for the year.) These tax returns are not open to public inspection. In addition, a nonexempt charitable trust, other than one which is required to distribute all its net income currently, must file an annual

information return (Form 1041–A), open to public inspection, setting forth certain information concerning its charitable contributions, income and expenses, and balance sheet items, but not containing all of the information required of exempt charitable trusts (sec. 6034). If a nonexempt charitable trust is a private foundation, it also must file a return (pursuant to the regulations under sec. 6011) setting forth much of the information contained on an exempt organization's information return, but this return (Form 5227) is not open to public inspection. In addition, a nonexempt charitable trust which is a private foundation must file the annual report (Form 990–AR or an equivalent report), which is open to inspection and must be furnished to the appropriate State officials as in the case of exempt private foundations, if the trust has at least $5,000 of assets.

Reasons for change

The committee believes that the private foundation reporting requirements should be simplified by combining the annual return (Form 990–PF) and annual report (Form 990–AR) into a single return containing the information presently required on each of the two separate documents. This will reduce administrative costs for foundations. Also, combining the two forms into one will increase the amount of information about the foundation available for inspection at the foundation's office and available to State officials.

Also, the committee believes that nonexempt charitable trusts described in section 4947(a)(1) of the Code should be required to report the same information and be subject to the same disclosure requirements as exempt charitable organizations.

Finally, the committee believes that the disclosure of the name and address of indigent or needy persons receiving grants of less than $1,000 in any year should not be required.

Explanation of provision

The bill eliminates the requirement (under sec. 6056) for the managers of any private foundation with assets of $5,000 or more to file an annual report. Instead, the bill requires that all information currently required to be furnished on the annual report (Form 990–AR) but not on the information return (Form 990–PF) be furnished instead on the foundation's annual information return (under sec. 6033). The combined annual information return will be subject to public inspection at the foundation's office and must be furnished to the appropriate State officials under the same conditions now applicable to the annual report.

In the case of a foundation which has no principal office or whose principal office is in a personal residence, it is anticipated that the Treasury will by regulation allow the annual inspection requirement to be met by having the return available for public inspection at an appropriate substitute location or by making copies of the return available by mail free of any charge (including postage and copying) upon request.

The bill also provides that the return not be required to contain the name and address of a needy or indigent recipient (other than a disqualified person) of a gift or grant made by the foundation where

the total of the gifts or grants received by the person during the year from the foundation does not exceed $1,000.

The section 6033 information reporting requirements under the bill will apply to nonexempt charitable trusts described in section 4947 (a)(1) as well as to exempt charities. If a nonexempt charitable trust is a private foundation, the trust's information return must contain all the information required of an exempt private foundation. In addition, nonexempt trusts described in Code section 4947(a)(1) will no longer be required to file a Form 1041–A (under section 6034). In the case of a nonexempt charitable trust which has no taxable income, the Treasury may prescribe regulations to treat the filing of the information return as satisfying the income tax return filing requirements (under sec. 6012). The filing by a trust of the annual information return under section 6033, in good faith, showing sufficient facts upon which to determine income tax liability will commence the period of limitations on any income tax liability if it is later determined that the trust in fact had taxable income.[1]

Effective date

This provision applies to taxable years beginning after December 31, 1980.

Revenue effect

This provision will not have any direct effect on budget receipts.

[1] This rule is consistent with the principles of the decision in *California Thoroughbred Breeders Association* v. *Commissioner*, 47 T.C. 335 (1966), acquiesced in by the Commissioner in Rev. Rul. 69–247, 1969–1 CB 303, in which it was held that the filing of a Form 990 information return by an exempt organization disclosing sufficient facts to apprise the Service of potential unrelated business taxable income commenced the statute of limitations although a tax return (990–T) was not filed.

C. Nonqualified Deferred Compensation Plans for Nonresident Aliens (sec. 3 of the bill and secs. 404A, 905, and 6689 of the Code)

Present law

United States businesses operating abroad often provide deferred compensation for their foreign employees. In many cases, plans are established which cover almost exclusively nonresident alien employees, rather than U.S. citizens working abroad. The foreign operations of the U.S. business may be conducted through a branch of a U.S. corporation or through a foreign subsidiary of a U.S. parent corporation.

General rules relating to deductibility of deferred compensation

In general, the year in which a taxpayer is allowed to deduct expenses, such as compensation, is determined by its method of accounting. Generally, cash basis taxpayers deduct expenses in the year they are paid, while accrual basis taxpayers deduct the expenses in the year in which all events have occurred which determine the fact of the liability and the amount of the liability can be estimated with reasonable accuracy.

However, the Code provides special rules (sec. 404) for deductions of amounts under pension and other deferred compensation plans, which must be met in addition to the usual requirements for deduction of the amounts as business expenses (secs. 162 and 212). Separate rules apply with respect to qualified and nonqualified deferred compensation plans.

Qualified plans.—In order for a deferred compensation plan to be "qualified" under the Code, contributions under it must be paid into a trust to protect them from the employer's creditors. A number of other requirements must also be met. In particular, the plan must be administered for the sole benefit of employees and their beneficiaries, eligibility to participate must be nondiscriminatory, contributions or benefits must be nondiscriminatory, and benefits must be paid no later than specified dates. Additional requirements must be met if the plan covers self-employed individuals, such as partners. The Employee Retirement Income Security Act of 1974 (ERISA) added a number of additional requirements, including, for example, new eligibility rules, minimum standards for vesting and accrual of benefits, minimum funding standards, maximum limitations on contributions and benefits, a requirement that benefits be paid in certain cases in the form of joint and survivor annuities, and prohibitions on certain dealings between the plan and related parties.

If a plan is qualified, a deduction is allowed at the time a contribution is paid into the plan's trust. The amount of the contribution allowable as a deduction is no less than the amount necessary to satisfy the minimum funding standard prescribed by ERISA. A maximum limitation is also placed on the amount of the contribution which may be deducted. Generally, this may not exceed the "normal cost" of the

plan for the year plus an amount which would amortize plan benefit liabilities attributable to past service of employees (if not already included in normal cost under the funding method used by the taxpayer) over a period of no less than 10 years. (The "normal cost" is a measure intended to reflect the ratable share of the increase in plan liabilities to participants resulting from service performed that year. Under some allowable funding methods, a ratable portion of liability for past service of the employees is also included in the year's normal cost). No deduction is allowed for contributions in excess of the "full funding limitation," the amount by which the accrued liability for benefits of the plan exceeds the value of its assets. Other limitations on deductions also apply if the employer maintains qualified profit sharing or stock bonus plans for his employees. An unlimited carryforward is allowed for contributions in excess of the limitations.

Nonqualified plans.—If a plan of deferred compensation does not meet the requirements for qualification under the Code, a separate rule applies to the deductibility of contributions. The deduction is taken in the taxable year in which an amount attributable to the contribution is includible in the income of the employee. A similar rule applies to deferred compensation arrangements with independent contractors. However, if the plan covers more than one employee, the deduction may be taken only if separate accounts are maintained for each employee. (Section 1022(j) of ERISA waives this requirement for certain plans to provide severance pay required by foreign law.) Otherwise, the IRS takes the position that the contribution is never deductible, except in the case of unfunded plans where payment is made directly to the former employees.

Separate accounts are established only for defined contribution plans, which generally require that an amount established pursuant to a formula, which may vary from employee to employee, be contributed to the accounts of the participants. Each employee bears the risk of fluctuations in the value of the investments in his account. Separate accounts are not maintained, however, for defined benefit plans. These plans specify by formula the benefits which participants are to receive on retirement. Contributions to them are based on actuarial calculations of the amounts which will be required to be paid out, generally based in the aggregate on the ages and life expectancies of members of the workforce, likely turnover of participants, and expected investment performance of amounts contributed. The employer bears the risk of investment gain or loss. Because the actuarial assumptions are based on aggregate data, no separate accounts are maintained. Hence, in situations where this rule applies, no deduction is allowed for contributions to a nonqualified defined benefit plan.

Foreign deferred compensation plans

Foreign branch operations.—The Code permits the trust of a qualified plan to be organized under foreign law and waives certain nondiscrimination rules with respect to nonresident aliens but does not otherwise expressly waive any of the requirements for qualification. In Letter Ruling 7904042, the Internal Revenue Service held that if a plan for the benefit of nonresident alien employees did not meet all of

the requirements for qualification under the Code (including the provisions added by ERISA), no deduction would be allowable under the rules for qualified plans described above. Instead, the Service held that amounts would be deductible, if at all, only under the rules which apply to nonqualified plans. Since the plans in question were defined benefit plans which did not maintain separate accounts for participants, the Service denied deductions for contributions made to the plans.

Foreign subsidiary operations.—Foreign subsidiaries of U.S. corporations generally do not have U.S. operations which would subject them to U.S. tax, and since their income is thus not subject to U.S. tax, the question of whether a deduction is allowed for contributions to a plan for nonresident aliens does not have the same direct effect on their U.S. tax liability as in the case of a foreign branch of a U.S. corporation. However, the treatment of the contribution in computing the foreign subsidiary's accumulated profits has important consequences in determining the indirect foreign tax credit which the U.S. parent corporation is allowed with respect to dividends received from the foreign subsidiary.[1]

Generally, if a U.S. corporation owns at least 10 percent of the voting stock of a foreign corporation from which it receives a dividend, the U.S. corporation is deemed to pay the amount of foreign income taxes paid by the foreign subsidiary on the accumulated earnings from which the dividend was paid. The U.S. corporation may then, within limitations, claim a credit against its U.S. tax liability in the amount of the foreign income taxes deemed paid by it. Under regulations, the determination of foreign taxes paid on accumulated earnings is made on a year-by-year basis, starting with the most recent year. If only part of the accumulated earnings of that year are paid out, only a proportionate part of the foreign income taxes paid with respect to the earnings for that year are deemed paid. Thus, if a dividend of a given size is paid, more of the foreign income taxes paid by the foreign subsidiary will be deemed to have been paid by (and thus would be creditable by) the U.S. parent if the accumulated earnings of the subsidiary are smaller than if they are larger—because a proportionately larger share of the accumulated earnings would be paid out in the dividend, resulting in a greater proportion of the foreign taxes being deemed paid.

The deduction issue discussed in connection with foreign branches can also be relevant in the case of a foreign subsidiary if it conducts a U.S. business, the taxable income from which must be determined, or if it is a controlled foreign corporation (CFC).[2]

In the case of a CFC, subpart F (secs. 951–964 of the Code) provides that, in general, the United States shareholders must currently include in their income certain types of tax haven income of the corporation and certain types of passive investment income. Generally, the amount

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[1] Section 406 of the Code permits, in limited instances, a U.S. parent corporation with a qualified plan to make contributions on behalf of employees of a foreign subsidiary who are U.S. citizens. In such cases, a deduction is allowed to the foreign subsidiary.

[2] Generally, a foreign corporation is a CFC if more than 50 percent of the voting power is held by "United States shareholders," that is, U.S. persons each of whom holds 10 percent or more of the voting power.

of this income to be taken into account is reduced by deductions properly allocable to that income, so if foreign pension costs are so allocable, it is necessary to determine whether and when they are deductible. Moreover, an indirect foreign tax credit similar to that described above may be allowed to the U.S. shareholder with respect to the amount which the shareholder must include in income. The credit is equal to the proportionate part of the foreign income taxes paid on the earnings and profits of the CFC from which the distribution is deemed to be made. Thus, questions similar to those described above arise as to the size of the earnings and profits.

In Letter Ruling 7839005, the Internal Revenue Service considered an accrual basis CFC which established an irrevocable balance sheet reserve for pension expenses. The taxpayer contended that the CFC's earnings and profits should be reduced by the amount of its pension liability which had properly been accrued. The Service held, however, that earnings and profits could be reduced only to the extent of pension payments actually made. The Service did not view as controlling the taxpayer's argument that this result would distort (generally by reducing) its allowable indirect foreign tax credit with respect to dividend distributions from the CFC.

Foreign trusts with U.S. beneficiaries.—The Code provides that if a U.S. person transfers property to a foreign trust, and a U.S. person is the beneficiary of any part of the trust, then the transferor is treated as the owner of the transferred trust property and therefore is taxable on the income earned on that part. Moreover, if the trust does not have a U.S. beneficiary at the time of the transfer but later acquires one, the transferor is subject to tax on all the undistributed net income on amounts it previously transferred to the trust. The Code expressly provides that these rules do not apply to foreign trusts established under qualified plans. However, there is no similar exception for foreign trusts under nonqualified plans. Thus, if a U.S. corporation makes a contribution to a foreign trust of a nonqualified plan, it is possible that the corporation would be taxable on the income earned on the contribution, either immediately if the trust has a U.S. person as a beneficiary, or subsequently if one of the plan participants or his beneficiary becomes a U.S. citizen or resident.

Reasons for change

The committee believes that the provisions of present law generally applicable to deferred compensation plans are ill-suited to plans maintained for the benefit of foreign employees. These plans must frequently comply with provisions of foreign law which are either inconsistent with U.S. law or can be made consistent only through the surrender of major tax benefits under the foreign system. The committee believes that U.S. employers should be able to obtain deductions (and adjustments to earnings and profits) which take into account their obligations under these plans. It is unnecessary to burden qualification for these tax benefits with many of the provisions intended to protect employees and their beneficiaries applicable to domestic plans. However, in order to prevent distortions of income or of the allowable foreign tax credit, the bill includes certain limitations on the allowable amount of deductions.

Explanation of provision

In general

The bill permits employers to elect a special set of provisions relating to deductions (and adjustments to earnings and profits) for qualified foreign plans. A "qualified foreign plan" means any written plan of an employer for deferring the receipt of compensation with respect to which the election has been made, but only if two requirements are met. First, the plan must be for the exclusive benefit of the employer's employees or their beneficiaries. Second, 90 percent or more of the amounts taken into account for the taxable year under the plan must be attributable to services (i) performed by nonresident aliens, (ii) the compensation for which is not subject to Federal income tax under the Code (as modified by applicable treaties). A plan is written to the extent it is defined by plan instruments, an applicable statute, or both. The bill does not apply to plans for independent contractors.

Under the bill, amounts paid or accrued by an employer under such a plan are not allowable as a deduction under Code sections 162, 212, or 404, but if they satisfy the conditions of Code section 162, they are allowable as a deduction under the bill for the taxable year for which the amounts are properly taken into account under the bill.

Certain provisions of the bill apply only to funded plans, while others apply only to reserve plans. Other provisions apply to both types. A qualified foreign plan is subject under the bill to the provisions relating to funded plans unless the taxpayer elects to be subject to the provisions for reserve plans.

The Committee intends that, for taxable years beginning after December 31, 1980 (and prior years to the extent the taxpayer elects retroactive effectiveness of the provisions), the taxpayer may claim a deduction for deferred compensation only pursuant to the terms of the bill, to the extent permitted for contributions to qualified plans, or to the extent permitted under section 404(a)(5). However, the Committee also intends that, for prior years, no inference should be drawn from the enactment of the legislation as to the deductibility of contributions to foreign deferred compensation plans.

Funded plans

Generally, in the case of a funded plan contributions are properly taken into account for the taxable year in which paid. However, a provision similar to that available to domestic plans permits in some cases delay in payment of the contribution up to the time the return for the year is filed.

A contribution will be taken into account only if it is paid to a trust (or the equivalent of a trust) for the exclusive benefit of employees or their beneficiaries, for a retirement annuity, or directly to a participant or beneficiary.

In the case of a defined benefit plan, limitations to prevent distortion of income or the allowable foreign tax credit are placed on the amount deductible in any year which are similar to the limits imposed on domestic plans, except that aspects of the domestic limitations which relate to the minimum funding requirements are omitted because the funding rules do not apply to qualified foreign plans. Deductions for contributions to profit sharing plans are also subject to

limitations similar to those imposed on domestic plans. Where more than one type of deferred compensation plan is maintained, the general rule limiting deductions for contributions to 25 percent of other compensation is also applicable. If the contributions paid in any year (reduced by certain amounts not allowable as deductions under the bill) exceed the foregoing limitations, a carryforward of the excess is permitted.

Reserve plans

In the case of an unfunded reserve plan, the amount properly taken into account for the taxable year is the reasonable addition for that year to a reserve for the taxpayer's liability under the plan. All benefits paid under the plan are to be charged to the reserve. In the case of a plan which is or has been a qualified reserve plan, an amount equal to the portion of any decrease for the taxable year in the reserve which is not attributable to the payment of benefits is to be included in gross income. The reserve must be decreased to the extent that it exceeds the taxpayer's liability properly taken into account.

The addition to the reserve is computed by discounting the accrued vested liabilities of the employer under the plan by an interest rate which is intended to approximate the amount which the employer could reasonably be expected to earn on funds invested in its business. The bill prescribes a formula for determining the permissible interest rate to be used in discounting the employer's liabilities under the plan in order to compute the amount allowable as an addition to the reserve for the year. The taxpayer may select a discount rate which is no more than 20 percent above, and not more than 20 percent below, the average rate of interest for long term corporate bonds in the appropriate foreign country for a 15-year period prior to the year of the adjustment to the reserve. Once a discount rate within this permissible rate has been selected by the taxpayer for the plan, that rate shall remain in effect for the plan until the first year for which the rate is no longer within the permissible range. If in any year the rate selected by the taxpayer ceases to fall within the permissible range, the taxpayer shall select a new rate of interest which is within the permissible range applicable for that year.

Unless otherwise required or permitted by the Treasury, the reserve for the taxpayer's liability is to be determined under the unit credit method modified to reflect the following requirements. First, an item shall be taken into account for a taxable year only if there is no substantial risk that the rights of the employee will be forfeited, and the item meets such additional requirements as the Treasury may by regulations prescribe as necessary or appropriate to ensure that the liability will be satisfied. Second, any increase or decrease to the reserve on account of the adoption of the plan or a plan amendment, experience gains and losses, any change in plan assumptions, and changes in the interest rate is to be amortized over a 10-year period. Other factors prescribed by regulations must also be amortized over the 10-year period. These could include, for example, adjustments in the reserve resulting from changes in levels of compensation on which benefits depend, or the vesting in one year of a benefit which was accrued in a prior year.

Consistency with foreign law

In the case of any qualified foreign plan, whether funded or reserve, the amount allowed as a deduction under the bill for any taxable year is equal to the lesser of (i) the cumulative U.S. amount, or (ii) the cumulative foreign amount, reduced in either case by the aggregate amount determined under the bill for all prior taxable years. "Cumulative U.S. amount" means the aggregate amount determined with respect to the plan under this provision for the taxable year and for all prior taxable years to which the bill applies. (This determination is to be made, however, for each taxable year without regard to the limitation imposed by this provision.) "Cumulative foreign amount" means the aggregate amount allowed as a deduction under the appropriate foreign tax laws for the taxable year and all prior taxable years to which this provision applies. If the deduction under the foreign tax law is later adjusted, the taxpayer is to notify the Treasury of the adjustment on or before the date prescribed by regulations, and the Treasury will redetermine the amount of the U.S. tax for the year or years affected. (In any such case, rules similar to the rules of Code section 905(c) will apply. See the discussion below under the heading "Foreign tax credit redeterminations.")

In determining the earnings and profits and accumulated profits of any corporation with respect to a qualified foreign plan, the principles of this limitation are generally to apply. However, the deduction allowed in computing the earnings and profits or the accumulated profits of any foreign corporation with respect to a qualified foreign plan is not in any event to exceed the amount allowed as a deduction under the appropriate tax laws for such taxable year. This additional limitation is imposed in response to the possibilities for distortion of a taxpayer's indirect foreign tax credit which are presented by the present annual system for determining the amount of the foreign taxes paid by a subsidiary which are attributable to dividends paid to its U.S. shareholders. The effective rate of foreign tax paid by a foreign subsidiary determined with reference to U.S. accounting rules may fluctuate significantly from year to year for a variety of reasons, including, in particular, differences between the U.S. accounting rules for computing the foreign subsidiaries earnings and profits or accumulated profits and the accounting rules used by the foreign government in imposing the tax. The interaction of these foreign rate fluctuations and the annual rules for computing the indirect foreign tax credit permit substantial distortions of the taxpayer's deemed paid foreign tax credit as compared with the effective tax rate of the subsidiary over a period of years. For example, dividends might be repatriated only in high effective tax rate years of the subsidiary (measured under U.S. accounting rules), yielding a deemed paid credit higher than the long term effective rate of the subsidiary. Conversely, dividends might be repatriated through years in which the subsidiary has no accumulated profits according to U.S. accounting rules, with the result that the taxes paid by the subsidiary for the year are lost. This potential for distortion might be eliminated if the indirect credit were computed with reference to the subsidiary's accumulated foreign taxes and undistributed accumulated profits for all years. Until and unless such a change so made, however, it was determined that no carryforward of

any amount which is disallowed for a year because the foreign deduction of the subsidiary for the year exceeded the U.S. deduction for the year will be permitted to a future year where it would increase the amount allowable under U.S. rules over the amount of the foreign deduction for the later year. (The impact of this limitation is that such an excess is permanently lost.)

Other limitations

The bill further provides that, except as provided in Code section 404(a)(5), no deduction will be allowed under the bill for any item to the extent it is attributable to services (i) performed by a citizen or resident of the United States who is an officer, shareholder, or highly compensated, or (ii) performed in the United States the compensation for which is subject to Federal income tax under the Code (as modified by applicable treaties).

No deduction is allowed under the bill with respect to any plan for any taxable year unless the taxpayer furnishes to the Treasury (i) a statement from the foreign tax authorities specifying the amount of the deduction allowed in computing taxable income under foreign law for the year with respect to the plan, (ii) if the return under foreign tax law shows the deduction for plan contributions or reserves as a separate, identifiable item, a copy of the foreign tax return for the taxable year, or (iii) such other statement, return, or other evidence as the Treasury prescribes by regulation as being sufficient to establish the amount of the deduction under foreign law.

Actuarial assumptions must be reasonable in the aggregate. Also, in the case of a reserve plan, rates of interest used for actuarial computations are to be the appropriate market interest rates for borrowing money in the appropriate country, as determined under regulations prescribed by the Treasury. No deduction is allowable for any amount to the extent that it would cause the fair market value of the plan's assets to exceed the accrued liability (including normal cost) under the plan. Any change in the method (but not the actuarial assumptions) used to determine the amount allowed as a deduction is to be treated as a change in accounting method under Code section 446(e). Thus, such a change would require the permission of the Treasury and could give rise to an adjustment to income (Code section 481). In applying section 481 with respect to any such election, the period for taking into account any increase or decrease in accumulated profits, earnings and profits or taxable income resulting from the application of section 481(a)(2) shall be the year for which the election is made and the nine succeeding years.

Foreign tax credit redeterminations

The allowance of deductions under the bill depends, in part, on the allowance of deductions under foreign law. The bill provides that when there is a change in deductions allowed under foreign law the taxpayer will be required to notify the Treasury of this change. This requirement parallels existing rules requiring notification if foreign taxes when paid differ from amounts claimed as credits by the taxpayer. The bill also clarifies enforcement of the provisions which require the taxpayer to notify the Treasury of changes in its foreign income tax liabilities.

The bill provides that interest may be assessed and collected on the tax due resulting from a redetermination if the taxpayer has failed to notify the Treasury (on or before the date prescribed by regulations for giving such notice) of the foreign tax change, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The interest may be assessed and collected, however, only from the time of the refund of foreign income tax or any adjustments affecting deductions allowable under the bill or the time of any other adjustment to foreign income tax paid or accrued. Moreover, if the failure is not excusable, an additional penalty is to be assessed of 5 percent of the deficiency attributable to the redetermination for each month (or fraction of a month) during which the failure continues, not to exceed 25 percent.

Foreign trusts

The bill would make it clear that in the case of a contribution to a foreign trust subject to the special deduction rules, the corporation making the contributions is not treated as the owner of part of the trust merely because the trust has or acquires U.S. beneficiaries.

Effective date

The amendments made by this provision are generally applicable to employer contributions or accruals by U.S. taxpayers and from subsidiaries of such taxpayers for taxable years after December 31, 1980. In addition, a taxpayer may elect to have the amendments apply retroactively. A retroactive election only applies to funded plans maintained by foreign branches of the taxpayer, but it applies to both funded plans or reserve plans maintained by foreign subsidiaries of the taxpayer. In the case of retroactive application to foreign subsidiaries, the legislation would apply to all dividends distributed out of accumulated profits and earnings and profits earned by such subsidiaries after December 31, 1971 and included in the taxpayer's income in its open period. Any retroactive election can only be revoked with the consent of the IRS. Any retroactive election shall apply to all open years of the taxpayer after December 31, 1971 (other than any open years which precede a closed year of the taxpayer).

Revenue effect

It is estimated that the provisions allowing a deduction for pension plans of foreign branches of U.S. corporations will reduce budget receipts by $20 million in fiscal 1981 and $10 million annually in 1982 through 1985. Although the tax liability involved in the case of unfunded accrual plans of foreign subsidiaries of U.S. companies is potentially far more substantial (possibly $500 million for the period prior to 1981 and $200 million a year thereafter, for several reasons the provisions involving foreign subsidiaries are estimated not to have any budget impact for the next few years. The affected taxpayers have contested the position of the IRS that accrual plans do not qualify for deductions in computing earnings and profits. Litigation resolving the issue is likely to take some time and thus, even if the IRS prevails, no U.S. tax on account thereof is likely to be paid for several years. Moreover, since taxpayers can avoid any U.S. tax liability with respect to the plans of the foreign subsidiaries if they fund those plans, it is not clear how much revenue, if any, would be raised if deductions are not allowed for foreign pension accruals.

D. Transfers of Proven Oil or Gas Properties to a Controlled Corporation (sec. 4 of the bill and sec. 613A of the Code)

Present law

Under present law, oil and gas production generally is not entitled to percentage depletion. However, independent producers and royalty holders are permitted a percentage depletion deduction of 22 percent with respect to 1,000 barrels of oil (the "depletable quantity") per day. Between the end of 1980 and the beginning of 1984, the rate of percentage depletion phases down from 22 percent to 15 percent.

Generally, present law requires the depletable quantity of oil and gas to be allocated among all the properties owned directly by the taxpayer, and among all the properties owned by certain other persons with specified relationships to the taxpayer. For this purpose, the following persons are treated as one taxpayer, and must be aggregated in applying the depletable quantity: component members of the same controlled group of corporations, businesses (including corporations, trusts, or estates) and members of the same family. Present law, however, does not require an allocation of the depletable quantity between a trust and a beneficiary of the trust, or between an individual and his or her controlled corporation. As a result, in these instances each taxpayer has a separate depletable quantity.

Under present law, production from a proven oil or gas property which has been transferred after December 31, 1974, generally is not eligible for percentage depletion. However, this rule generally does not apply to testimentary transfers, certain changes in trust interests, or to specified situations where the transferor and the transferee must allocate one depletable quantity following the transfer. If the allocation rule applies, this special exception to the general prohibition on the transfer of proven oil or gas properties applies to transfers covered by section 351, i.e., to transfers to a corporation which is controlled by the transferor(s) after the transfer. Since the depletable quantity is not allocable between an individual and his or her controlled corporation, this special exception is inapplicable to such transfers. As a result, percentage depletion is not available with respect to production from a proven oil or gas property which has been transferred after 1974 by an individual to his or her controlled corporation.

Reasons for change

The committee believes that the percentage depletion transfer rules may be unnecessarily complex and restrictive in the case of transfers of proven oil or gas properties by individuals to a controlled corporation. The committee believes that these rules, in some instances, may result in an unintended denial of percentage depletion where individuals transfer proven oil or gas properties without thorough consideration of the income tax consequences provided for under present law. Nevertheless, the committee also recognizes the importance of preventing a proliferation of the aggregate number of barrels of oil or gas pro-

duction with respect to which an individual may benefit from percentage depletion, and of preventing an increase in the overall number of percentage depletion exemptions.

The committee believes that the various important business, estate planning, and tax policy considerations involved in Congress' restriction on eligibility for percentage depletion from oil and gas production can be reconciled in some situations not provided for currently in the Code. These instances are where only oil or gas properties are transferred by individuals to a controlled corporation solely in exchange for stock of that corporation, and where an election is made to share one depletable quantity. Therefore, the committee believes that it is appropriate to amend the rules of present law relating to transfers of proven oil or gas properties by individuals to a controlled corporation. To effectuate the reconciliation of the competing considerations involved, the committee has limited its action to transfers by individuals which involve only an exchange of stock for oil or gas properties.[1]

Explanation of provision

The bill provides a limited exception to the generally applicable rules of present law which prohibit oil and gas production from being eligible for percentage depletion if the production is from a proven oil or gas property which has been transferred by an individual to a controlled corporation after December 31, 1974. This limited exception applies only to transfers by individuals, and only where an irrevocable election is made to have the provision apply. There is no limit on the number of individuals who may make transfers of qualified property solely in exchange for stock of the transferee corporation. Similarly, there is no restriction on when such transfers may be made (other than those in the effective date of this provision) and, thus, qualifying transfers need not be made simultaneously.

If the requirements of the bill are satisfied, the provision would allow individuals to transfer oil or gas properties to a controlled corporation without the loss of percentage depletion.[2] The transferee corporation and the transferor(s), however, would have to share one 1,000-barrel amount for percentage depletion purposes.

The bill's exception to the percentage depletion transfer rule applies only to exchanges to which section 351 of the Code (relating to nonrecognition of gain on transfers to a controlled corporation) applies. In addition, the bill imposes other requirements (under new Code sec. 613A(c)(10)) which also must be satisfied. Specifically, the bill provides that the transfer rules of present law (sec. 613A

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[1] The committee previously has reported provisions which would apply to more situations than those covered by this bill. *See* H.R. 1212 (S. Rept. No. 96-532, 96th Cong., 1st Sess. (1979)) and H.R. 2492 (S. Rept. No. 96-684, 96th Cong., 2d Sess. (1980)).

[2] The term oil or gas property has the same meaning, for purposes of the amendment, as under section 613A(c)(9) (relating to transfers of proven oil or gas properties). Therefore, the term means an oil or gas mineral interest within the meaning of section 614 of the Code.

Only proven oil or gas properties are subject to the transfer restrictions of Code section 613A(c)(9). A property is treated as a proven oil or gas property if the principal value of the property has been demonstrated, at the time of the transfer, by prospecting, exploration, or discovery work.

(c)(9)(A)) do not apply to a transfer of "qualified property" by individuals to a "qualified transferee corporation" solely in exchange for stock in such corporation. For this purpose, the term "qualified transferee corporation" means a corporation all of the outstanding stock of which has been issued directly to the individual transferors solely in exchange for "qualified property" held by such individuals. (Initial transfers of "qualified property" to such a corporation would meet the requirements of the provision even though the corporation may have no outstanding stock issued prior to the time of the initial transfer.) A "qualified transferee corporation" may issue stock only in exchange solely for "qualified property." No debt instruments or similar obligations may be issued in exchange for such property, and no stock may be issued for property which is not "qualified property" transferred to the corporation by individuals. As a result, stock of a "qualified transferee corporation" never may be issued for property which is not "qualified property" held by an individual. Similarly, a corporation which has issued any stock for property which is not "qualified property" cannot be a "qualified transferee corporation," even if the stock was issued prior to the effective date of the bill or before a transfer of oil or gas property to the corporation which otherwise might qualify under the amendment. Moreover, the corporation's stock would not be considered to be issued to individuals solely in exchange for a transfer of their "qualified property" if the transfer and stock issuance are part of an indirect sale arrangement between the transferors.

The term "qualified property" means only oil or gas property with respect to which there has been no prior transfer to which the general percentage depletion transfer rules (sec. 613A(c)(9)(A)) applied[3], and with respect to which the transferor has made an election to have the bill's rules apply. Thus, the term "qualified property" includes both proven and unproven oil or gas property, but *no* other property. Notwithstanding this strict limitation of the term "qualified property," it also includes cash, but not in excess of $1,000 in the aggregate, transferred to the corporation by one or more individuals.

To determine whether the requirements of new paragraph (10) of section 613A(c) are satisfied, the amendment uses a variation of the generally applicable rules relating to assumption of liabilities in connection with a transfer to a controlled corporation (Code sec. 357). (This modification of the ordinarily applicable section 357 tests are *in addition to* the requirement that a transfer meet the terms of section 351 of the Code. In other words, a transaction must meet both the more general requirements of section 351 and the more restrictive tests of the amendment.) For purposes of applying the modified section 351 tests, section 357(a) is applied (subject to the limitations of section 357 (b) relating to tax avoidance and (c) relating to liabilities in excess of basis) as if its references to section 351 included references to the requirement of the amendment that qualified property be transferred solely in exchange for stock in a qualified transferee corporation. In addition, section 357(a)(1) is to be applied as if its reference

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[3] See note 2, *supra*. Code section 613A(c)(9)(B) lists the cases in which the general transfer rules of section 613A(c)(9)(A) do not apply.

to nonrecognition of gain includes a reference to the inapplicability of the general percentage depletion transfer rules (sec. 613A(c)(9)(A)). Consequently, the amendment could apply if an individual transfers qualified property to a qualified transferee corporation solely in exchange for stock of that corporation, and in such a manner that the general, proven property, percentage depletion transfer rules (sec. 613A(c)(9)(A) of the Code) otherwise are inapplicable. Moreover, if such a qualified transferee corporation assumes a liability of the transferor (or acquires qualified property subject to a liability), then such an assumption or acquisition by the corporation is not treated as money or other property for purposes of disqualifying a transfer under new paragraph (10). Therefore, such a transfer involving liabilities would not prevent an otherwise qualifying exchange from being within the terms of the amendment.

In applying these modifications of section 357 it is intended that section 357 should be construed in view of the legislative purposes of section 613A and section 357 (including subsections (b) and (c)). As a result, the amendment's requirements that stock be issued directly by the qualified transferee corporation to the transferor solely in exchange for qualified property would not be satisfied if the transfer constituted, e.g., an indirect sale. For instance, a transfer would not qualify under new paragraph (10) if it were utilized to increase the proportionate ownership of one transferor in relation to another transferor.[4] Similarly, new paragraph (10) would not apply if one transferor receives stock from the transferee corporation and another (other than the transferee corporation) assumes, or becomes responsible for the satisfaction of, a liability of the transferor or to which the transferred property is subject.

The bill's exception to the general percentage depletion transfer rules applies only so long as the transferor retains the stock of the qualified transferee corporation. If any transferor makes a lifetime disposition of his or her stock in a qualified transferee corporation, then the corporation's depletable quantity (as determined without regard to the bill's exception) must be reduced for all periods on or after the date of that disposition. This reduction is equal to an amount which bears the same ratio to the corporation's depletable quantity (as determined without regard to the bill's exception) as the fair market value of the stock disposed of bears to the aggregate fair market value of all outstanding stock of the corporation on the date of the disposition.

Special rules, however, apply to certain interfamily transfers. A transferor may make a lifetime disposition of stock in a qualified transferee corporation to a member of his or her family without having the disposition result in a reduction in the corporation's depletable quantity. However, the corporation's depletable quantity would have to be reduced if stock transferred to such a family member ceased to be held by a member of the transferor's family. For this purpose, members of the transferor's family include only his or her spouse and minor children (and only so long as they retain that status). The bill provides similar special rules applicable to the issuance of stock in a

[4] The same result would occur (as under present law) if only the section 357 requirements applied. *See* Treas. regs. sec. 1.351-1(b)(1); S. Rept. No. 1622, 83d Cong., 2d Sess. 264 (1954).

qualified transferee corporation to members of the transferor's family. Under these rules, stock issued to a member of the transferor's family is treated as having been issued directly to the transferor.

Transfers of stock in a qualified transferee corporation by reason the death of a transferor do not result in a reduction of the corporation's depletable quantity. Similarly, upon the death of a transferor, the recipient (other than the transferor's spouse) of the transferor's stock in a qualified transferee corporation need not retain such stock. A disposition of stock by such a recipient will have no affect on the continued applicability of the exception contained in the committee bill.

The bill provides generally that a "tentative quantity" (within the meaning of sec. 613A(c)) is to be determined for the qualified transferee corporation under the new rules pertaining to transfers of qualified property by individuals to such a corporation. Similarly, the bill provides that the tentative quantity for the transferor (and the transferor's family) for any period is to be reduced by the transferor's pro-rata share of the corporation's depletable quantity for that period. For purposes of computing the transferor's pro rata share of the corporation's depletable quantity for a period, a transferor's pro rata share is determined with regard to production from proven oil or gas properties plus production from all other property. In the case of production from a proven oil or gas property, the transferor's pro rata share for any period is that portion of the corporation's depletable quantity which is allocable to production from such property. In the case of production from an unproven oil or gas property, the transferor's pro rata share for any period is that portion of the corporation's depletable quantity which is allocable to production from such property. This amount is multiplied by a fraction, the numerator of which is the fair market value of the transferor's stock in the corporation and the denominator of which is the fair market value of all stock in the corporation. For purposes of the committee's bill, and for computing the reduction in the transferor's tentative quantity, a corporation's depletable quantity for any period is the lesser of (1) the corporation's tentative quantity for any period (determined under sec. 613A(c)(3) and (8)), or (2) the corporation's average daily production for the period.

Except to the extent provided in the provisions of the bill, the generally applicable rules of section 613A continue to apply, as do rules provided in other Code sections which are consistent with the terms, purpose, and policy of this amendment. To ensure this result, the bill specifically grants the Secretary broad authority to prescribe such regulations as may be necessary to accomplish the purposes of the amendment and to prevent a proliferation of the amount of oil or gas subject to percentage depletion.

The provisions of the bill are elective, and apply for only so long as an election is in effect and the terms of the provision otherwise are satisfied. An election under the bill must be made only in such manner as the Secretary may prescribe by regulations. It must be made on or before the due date, including extensions, for filing the corporation's income tax for the corporation's first taxable year ending after the date of the transfer (or, if later, after the date of enactment).

The provisions of the bill will apply with respect to post-1979 oil or gas production from proven oil or gas properties transferred after

1974 by individuals. However, for an election to be made under the bill, its requirements must have been satisfied at the time of the transfer and at all times thereafter. Therefore, the amendment will not apply to production from a proven oil or gas property which has been transferred after 1974 if the transfer would not have been allowable under the terms of the bill had the bill been effective on the date of the transfer.

Effective date

The provision will apply to production of oil and gas after December 31, 1979, from property transferred after December 31, 1974.

Revenue effect

It is estimated that this provision will reduce fiscal year budget receipts by $15 million in 1981, by $17 million in 1982, by $19 million in 1983, by $23 million in 1984, and by $26 million in 1985.

E. Tax Credits Allowable Against Alternative Minimum Tax (sec. 5 of the bill and sec. 55 of the Code)

Present law

Under present law, an alternative minimum tax is payable by noncorporate taxpayers to the extent that the tax on the alternative minimum taxable income exceeds their regular income tax, including the "add-on" minimum tax (Code sec. 55).

In general, the alternative minimum taxable income is based on the sum of the taxpayer's gross income, reduced by allowed deductions, and increased by tax preference items, i.e., adjusted itemized deductions and the section 1202 capital gains deduction. The alternative minimum tax rate is 10 percent for amounts from $20,000 to $60,000; 20 percent for amounts from $60,000 to $100,000; and 25 percent for amounts over $100,000.

Present law provides several credits which ordinarily may be used to offset income tax liability. Some of these credits are intended to take into consideration previously paid taxes, and others are intended to encourage particular activities. The regular investment credit, for example, is equal to 10 percent of the cost of investments in certain tangible business property. (Code secs. 38, 46–48).

Tax credits generally are nonrefundable, but excess credits may be carried over to other years. For example, the regular investment credit may be used to offset the first $25,000 of tax liability plus a percentage of tax liability in excess of $25,000. This percentage is 70 percent in 1980 and will increase to 80 percent in 1981 and 90 percent for 1982 and later years. Excess investment credits from a taxable year may be carried over to apply against tax liability for the three proceeding and seven succeeding years on a first-in, first-out basis.

As a general rule, only refundable tax credits may be claimed against the amount of the alternative minimum tax. The only nonrefundable tax credit that may offset this tax is the foreign tax credit. Refundable credits are allowed to reduce the alternative minimum tax because such credits would be available to taxpayers in any event. In addition, generally refundable credits and the foreign tax credit represent taxes actually paid.

If the alternative minimum tax applies, present law provides that nonrefundable credits may continue to offset so much of a taxpayer's overall tax liability as does not exceed the applicable percentage of the taxpayer's regular taxes. Nonrefundable credits, therefore, are not allowable against any tax in excess of the regular income tax. However, credit carryovers are restored to the extent they did not result in a reduction of tax by reason of the alternative minimum tax.

Reasons for change

The committee is concerned with the present law rule which provides that nonrefundable tax credits may not be claimed against the

alternative minimum tax. Because of this rule, a taxpayer may not currently be able to take full advantage of otherwise allowable tax credits for the current year even though the taxpayer has few or no tax preferences. Therefore, the committee bill allows the nonrefundable tax credits against the portion of alternative minimum tax which is not attributable to net capital gains and adjusted itemized deductions, if the credits are attributable to the active conduct of a trade or business by the taxpayer.

Explanation of provision

Under this provision of the bill, nonrefundable tax credits (other than the foreign tax credit) will be permitted to offset the alternative minimum tax except to the extent that the alternative minimum tax is attributable to net capital gains and adjusted itemized deductions. However, in the case of the investment tax credit, WIN credit, and new jobs credit, this offset will be available only to the extent the credit is attributable to the active conduct of a trade or business by the taxpayer.[1]

[1] This provision may be illustrated by the following example. Assume that in 1981, an individual has a $60,000 income tax liability determined under section 1, and has an investment tax credit of $45,000 and a WIN credit of $5,000 (all attributable to his conduct of an active trade or business), thus resulting in a regular tax (as defined in Code section 55(b)(2)) of $10,000 ($60,000 tax less $50,000 credits). Further assume that the individual's alternative minimum tax is $12,000 ($22,000 amount computed under section 55(a)(1) less $10,000 regular tax) and that such minimum tax would be $2,000 ($12,000 less $10,000) if the alternative minimum taxable income were reduced by net capital gains and adjusted itemized deuctions.

Under the bill, $2,000 of the alternative minimum tax may be reduced by the tax credits. For purposes of determining the amount of any credits which can be taken against the alternative minimum tax, the amount of the WIN credit is increased by $5,000 (the lesser of the $5,000 credit allowable against the section 1 tax or the $12,000 tax imposed by section 55(a)), and the amount of the investment tax credit is increased by $7,000 (the lesser of $45,000 credit allowable against the section 1 tax or the $12,000 section 55 tax reduced by the $5,000 WIN credit increase). These credits may be used to reduce the section 55 tax for 1981, but may not be used to reduce the 1981 section 1 tax (sec. 55(c)(1)(B)). Therefore, for 1981, the taxpayer's total tax liability will be $20,000 computed as follows: $60,000 (under section 1) plus $12,000 (under section 55) minus (i) investment credits of $47,000 ($45,000 plus $2,000) and (ii) WIN credits of $5,000.

The amount of the unused credits available for carrybacks and carryovers is to be $5,000 for the investment tax credit and $5,000 for the WIN credit, determined as follows:

For purposes of applying section 46(b), the tax liability determination (under section 46(a)(3)) is $47,000—the $45,000 investment tax credit allowable in computing the regular tax (since this amount is less than the actual amount determined under section 46(a)(3)), plus the $2,000 amount determined under section 55(c)(1)(A)). For this purpose, the tax credits are $52,000 ($45,000 actual credits plus $7,000 increase under section 55(c)(2)(A)). Thus, the amount of excess credits is $5,000 ($52,000 less $47,000).

For purposes of applying section 50A(b), the tax liability determination (under section 50A(a)(2) is $5,000—the $5,000 WIN credit allowable in computing the regular tax (since this amount is less than the actual amount determined under section 50A(a)(2)), plus zero (the $2,000 amount determined under section 55(c)(1)(A) less the $2,000 investment tax credit allowable against the section 55 tax). For this purpose, the tax credits are $10,000 ($5,000 actual credit plus $5,000 increase under section 55(c)(2)(A)). Thus, the amount of the excess credits is $5,000 ($10,000 less $5,000).

The use of the carryovers of the excess credits is not limited to use against the section 55 tax.

Effective date

The provision will apply with respect to taxable years beginning after December 31, 1979.

Revenue effect

It is estimated that this provision will reduce fiscal year budget receipts by $99 million in 1981, $72 million in 1982, by $57 million in 1983, by $39 million in 1984, and by $22 million in 1985. The fiscal year 1981 loss includes $70 million from calendar year 1980 liability.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL AS AMENDED

Budget Effect

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made about the effect on the budget of this bill, H.R. 4155, as amended. The committee estimates that the bill will reduce budget receipts by $134 million in fiscal year 1981, $99 million in fiscal year 1982, $86 million in fiscal year 1983, $72 million in fiscal year 1984, and $58 million in fiscal year 1985.

New Budget Authority and Tax Expenditures

In accordance with section 308 of the Budget Act, after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority, but will increase tax expenditures by $114 million in fiscal year 1981, $89 million in 1982, $76 million in 1983, $62 million in 1984, and $48 million in 1985.

Consultation with Congressional Budget Office on Budget Estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated above) and agrees with the methodology used and the resulting revenue estimates.

Vote of the Committee

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 4155, as amended, was ordered favorably reported by voice vote.

IV. REGULATORY IMPACT OF THE BILL

In compliance with paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the regulatory impact that might be incurred in carrying out the provisions of this bill, H.R. 4155, as reported by the committee.

Individuals and businesses regulated and economic impact of regulation.—This bill does not regulate any individuals or businesses, but amends certain provisions of the tax law. The bill, as amended, deals with provisions authorizing the Secretary of the Treasury to disclose to the Secretary of Education the mailing addresses of taxpayers who have defaulted on certain student loans, simplifying the private foundation return and report requirements, the deductibility of employer contributions to pensions of foreign employees, transfers of proven oil and gas properties to a controlled corporation, and the tax credits allowable against the alternative minimum tax.

Impact on personal privacy.—The provisions of the bill will have minimal impact on personal privacy. Personal privacy would be protected by the provision under which a private foundation need not disclose the name and address of an indigent or needy person receiving a grant of less than $1,000 on its returns subject to public inspection.

Determination of paperwork involved.—The provisions of the bill will reduce the reporting and other paperwork of private foundations.

V. 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, H.R. 4155, as reported by the committee).

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