Calendar No. 956

97TH CONGRESS 2d Session | SENATE | REPORT No. 97-662

TAX ON FAILURES TO COMPLY WITH CERTAIN DETERMINATION LETTERS

OCTOBER 18, 1982—Ordered to be printed

Filed under authority of the order of the Senate of October 2 (legislative day, September) 18, 1982

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

REPORT

[To accompany H.R. 7094]

The Committee on Finance, to which was referred the bill (H.R. 7094) to amend the Internal Revenue Code of 1954 to impose a tax on failures to adhere to conditions of determination letters relating to independent management of the assets of multiemployer pension plans, having considered the same, report favorably thereon with an amendment to the text and an amendment to the title and recommends that the bill as amended do pass.

The amendment is shown in the text of the bill in italic.

House bill.—The bill as passed by the House imposes an excise tax on failures to adhere to conditions of determination letters relating to independent management of the assets of multiemployer pension plans.

Committee bill.—The bill as amended by the Committee on Finance includes the House-passed provision, and amendments relating to (1) rollover of qualifying distributions to an IRA, (2) tax treatment of amounts received in settlement of Westinghouse uranium litigation, (3) treatment of employer-provided faculty housing, and (4) enterprise zone incentives.

99-184 O

I. SUMMARY

Excise tax on failures to comply with certain determination letters

Under present law, if a favorable determination letter issued by the Internal Revenue Service to a pension plan is conditioned on certain requirements (including a requirement that the assets held in trust under the plan be independently managed) and such a condition is violated by the plan trustees or plan administrator, the only remedy potentially available to the Internal Revenue Service is revocation of the trust's tax-exempt status. This disqualification sanction does not directly affect a plan trustee or administrator who violates the condition.

The bill imposes a new excise tax sanction on multiemployer plan trustees or administrators who violate an independent asset management condition in a determination letter issued before September 15, 1982, if the plan agreed to the condition in writing before that date.

Qualifying rollover distributions to an IRA

If a lump sum distribution is paid to an employee under a qualified pension, profit-sharing, or stock bonus plan, tax is deferred on the portion of the distribution rolled over within 60 days to another qualified plan or to an IRA (an individual retirement account, annuity or bond).

A distribution to an employee from a qualified plan is not a lump sum distribution unless (1) the distribution consists of the balance to the credit of the employee under the plan, and (2) the distribution is made within one taxable year of the recipient.

The bill grants special relief for certain pension plan distributions received during 1976 and 1977 and transferred to an individual retirement account.

Under the bill, the transfers would be treated as a tax-free rollover.

Treatment of amounts received in settlement of Westinghouse uranium litigation

The bill provides that a utility would not include any amount in income for future discounts or price reductions provided pursuant to its settlement with Westinghouse of litigation regarding certain contracts to provide nuclear fuel to the utility. Any price reduction under the agreement would be excluded from the cost of the goods or services to which the reduction relates.

Applicability of fringe-benefit moratorium to employer-provided faculty housing

Under certain circumstances, present law excludes from an employee's gross income the value of lodging provided by the employ-

er. In addition, present law prohibits the Treasury from issuing final regulations relating to the income tax treatment of fringe benefits prior to January 1, 1984.

The bill provides that the fringe-benefit moratorium applies to housing that is furnished to employees of educational institutions at below fair market value, provided that certain conditions are met. The provision is effective upon enactment.

Incentives for enterprise zones

Under the bill, up to 25 enterprise zones per year could be designated by the Secretary of the Department of Housing and Urban Development for each of 3 years, beginning with the 12-month period that starts on July 1, 1983. Each enterprise zone so designated would be eligible for Federal tax relief, including an employment credit or investment credit, elimination of taxation on capital gains, and full cost recovery deductions on property financed with industrial development bonds. Federal regulatory relief also would be authorized.

The duration of each zone would be 20 years, plus a 4-year phaseout period. Areas would be nominated for enterprise zone designation by one or more local governments and the State in which the area is located. Areas nominated for such a designation would have to meet certain criteria of economic distress, and designations would be made through a competitive process weighing suggested plans for developing the area through tax and regulatory relief, improved services, and involvement of neighborhood and community organizations and private entities in development efforts.

II. EXPLANATION OF THE BILL

A. Excise Tax on Failures To Comply With Certain Pension Plan Determination Letters (sec. 201 of the bill and sec. 4976 of the Code)

Present law

Background

In 1976, the Internal Revenue Service revoked the tax-exempt status of the Teamsters' Central States Pension Fund, a multiemployer pension plan, stating that the Fund was not being managed for the exclusive benefit of the participants and beneficiaries. The action was due to evidence of large-scale misuse of Fund assets. During 1977, Fund assets (now approximately $3.5 billion) were placed under the control of independent asset managers (the Equitable Life Assurance Society and Victor Palmieri and Company, Inc.) as a condition of the reinstatement of the Fund's exempt status.

On November 11, 1981, the Internal Revenue Service issued a new favorable determination letter to the Fund. This letter includes an independent asset management condition. The condition was agreed to in writing on behalf of the Fund. Under present law, revocation of the Fund's tax-exempt status is the only remedy potentially available to the Internal Revenue Service if the condition is violated.

Revocation of tax-qualification

Under present law if the tax exemption of a trust forming a part of a pension plan is revoked (1) the trust is no longer exempt from tax, (2) plan participants and beneficiaries are taxed on plan benefits as the benefits vest, and (3) deductions for employer contributions may be disallowed. However, these disqualification sanctions are ineffective with respect to a plan like the Teamsters' Central States Pension Fund. The Fund has approximately 500,000 participants and beneficiaries and thousands of contributing employers. Any effort to establish an annual income inclusion for each participant or beneficiary is impractical. Also, disallowance of employer deductions could seriously affect contributing employers and impair the Fund's ability to pay benefits to participants and beneficiaries.

The disqualification sanctions do not directly impact plan trustees or the plan administrator.

Reasons for Change

The committee believes that a more appropriate remedy should be available to the Internal Revenue Service to deter violations of

agreed upon independent asset management conditions included in existing determination letters.

The bill follows the request of the Administration that the Congress take prompt action on legislation to provide an additional remedy (i.e., other than revocation of tax-qualification) to more effectively safeguard plan assets for the benefit of participants and beneficiaries.

Explanation of Provision

The bill imposes a new excise tax sanction in any case in which (1) a favorable determination letter issued by the Internal Revenue Service to a multiemployer pension plan before September 15, 1982, is conditioned upon some or all plan assets being held by a qualified (i.e., professional, and of national stature) independent asset manager, (2) the determination letter is agreed to in writing by or on behalf of the plan before September 15, 1982, (3) the Secretary has not agreed in writing to a withdrawal of the condition, and (4) a plan trustee or administrator takes any action which he knows (or should know) will result in a violation of the independent asset management condition. For example, where a trustee is unaware of a violation when it occurred, the sanction would be imposed if the trustee failed to take corrective action after he knows (or should know) of the violation. The sanction applies where the independent asset management condition is violated after the effective date of the provision if the condition was agreed to before September 15, 1982.

The tax is imposed on the trustee or administrator for each month for which the violation is in effect in an amount equal to one-half of one percent of the fair market value of the assets involved in the violation. However, the amount imposed with respect to a plan for any month cannot exceed $400,000.

Under the bill, the liability of trustees or administrators with respect to a violation is joint and several. In addition, if a trustee's assets are not sufficient to pay the tax for any month, the organization which appointed the trustee is secondarily liable.

Under the bill, if a taxpayer establishes to the satisfaction of the Secretary of the Treasury that an action (or failure to act) is due to reasonable cause, and that the taxpayer has taken action to correct the violation, then all or a part of the excise tax may be abated. The Secretary of the Treasury is to consult with the Secretary of Labor before abating any such tax.

Effective Date

The provision applies with respect to actions taken (or not taken) by a plan trustee or plan administrator after September 14, 1982.

Revenue Effect

It is estimated that the provision will have a negligible effect upon budget receipts.

B. Qualifying Rollover Distributions to an IRA (sec. 204 of the bill)

Present Law

If a lump sum distribution is paid to an employee under a qualified pension, profit-sharing, or stock bonus plan, tax is deferred on the portion of the distribution rolled over, within 60 days, to another qualified plan or to an IRA (an individual retirement account, annuity, or bond).

A distribution from a qualified plan is not a lump sum distribution unless it consists of the balance to the credit of the employee under the plan, and is made within one taxable year of the recipient. Because of these rules and because of then-existing uncertainty as to the application of certain rules relating to prohibited self-dealing, certain distributions made in 1976 and 1977 were not qualifying rollover contributions.

Reason for Change

The committee believes that the tax-free rollover rules, as applied to certain distributions made in 1976 and 1977 are unduly restrictive.

Explanation of Provision

The bill allows special relief for certain pension plan distributions received from a qualified terminated pension plan during 1976 and 1977 and subsequently rolled over to an IRA. Under the provision, the transfers would be treated as qualifying rollover contributions. Thus, to the extent the payments were, in fact, rolled over to an IRA within 60 days of receipt, the distribution will not be includible in income.

In addition, the bill extends the usual period of limitation for filing a claim for credit or refund of taxes paid (generally, three years after the later of (1) the date prescribed for filing the tax return, or (2) the date the return was actually filed). Under the provision, the statutory period of limitation is extended to permit the filing of a claim for credit or refund, attributable to changes made by the bill, within one year after the date of enactment.

Effective Date

The provision is effective upon enactment.

Revenue Effect

It is estimated that the provision will have a negligible effect on budget receipts.

C. Tax Treatment of Amounts Received in Settlement of Westinghouse Uranium Litigation (sec. 203 of the bill)

Present Law

Generally, income is includible in gross income of an accrual basis taxpayer for the taxable year in which all events have occurred to fix the right to receive the income and the amount thereof can be determined with reasonable accuracy (Treas. Regs. §1.451-1(a)).

During the late 1960s and early 1970s, electric utilities throughout the country entered into contracts with Westinghouse Electric Corporation to purchase nuclear fuel at an average contract price of about $8–$10 per pound of uranium. Westinghouse planned to fulfill its contract obligations through its own production and by purchases from other sources. However, when the market price for uranium rose to more than $25 per pound in 1975, Westinghouse refused to deliver uranium at the contract price, arguing that it was excused from its contractual obligations by reason of commercial impracticability. This action by Westinghouse gave rise to court suits which were settled in 1979, by which time the price of uranium had increased to over $40 per pound.

Under the terms of the settlements with electric utilities, Westinghouse agreed to provide cash payments, a future supply of uranium at prices higher than the original contract price but less than market prices, plus other goods and services at discounted prices. The total settlement benefits are estimated to exceed $1.8 billion and will be received by the utilities over a period as long as 28 years from the year of the settlement.

In a private letter ruling (LTR 8134189), the Internal Revenue Service has taken the position, under the facts and circumstances for one case, that the settlement constitutes a taxable event, generally resulting in taxation to the utility requesting the ruling (in the year of the settlement) of the present value of the settlement benefits. For accrual-basis taxpayers, the Service's position is that damages for breach of contract are includible in income for the year in which the settlement is reached.

Reasons for Change

The committee believes that it is appropriate to resolve this particular controversy with a legislative solution for several reasons. The circumstances involved are unique and therefore distinguishable from most other cases involving the question of when income is includible in gross income for damages received for a breach of contract. The settlement involves a substantial amount, relates to regulated public utilities, and covers an extended period of time during which the utilities will actually receive the discounts agreed

upon. Because the utilities may not in fact make the future purchases necessary to earn the discounts, serious valuation questions are also involved. Further, because of the substantial amounts involved, current taxation of the settlement benefits to be received in the future might adversely affect the financial condition of the highly capital-intensive utilities to some extent.

Explanation of Provision

Under the provision, no amount would be included in the income of a utility by reason of discounts or price reductions to be provided by Westinghouse Electric Corporation in settlement of the litigation of Westinghouse's contractual obligation to provide nuclear fuel to the utility. For purposes of determining investment credits, depreciation allowances, deductions for business expenses, etc., the utility's cost for the goods or services is the cost as reduced by the price discounts or reductions. The provision would not affect the tax consequences of any cash payments by Westinghouse to utilities under the settlement.

The provision does not provide any special rule for determining the taxable year for which deductions, if any, are allowable to Westinghouse with respect to the settlement.

The committee intends that no inference is to be drawn from the provision as to any other situations involving the question of the taxable year of inclusion of breach of contract damages awarded to an accrual basis taxpayer.

Effective Date

The provision applies to the taxable year in which the taxpayer obtained its settlement with Westinghouse and to all susequent taxable years.

Revenue Effect

The provision is not estimated to affect budget receipts unless the courts uphold the position taken by the Service. If the Service prevails, receipt reductions attributable to the provision would probably occur in fiscal years after 1987 because of the timing of the audit process and delays of litigation.

D. Applicability of Fringe-Benefit Moratorium to Employer-Provided Faculty Housing (sec. 202 of the bill)

Present Law

Employer-provided housing

Present law (Code sec. 119) excludes from an employee's gross income the value of lodging provided by the employer if (1) the lodging is for the convenience of the employer, (2) the lodging is on the business premises of the employer, and (3) the employee is required to accept the lodging as a condition of employment.

ERTA extension of fringe-benefit moratorium

Section 801 of ERTA extended, through December 31, 1983, the legislative moratorium (first enacted in 1978) prohibiting the Treasury from issuing final regulations relating to the income tax treatment of fringe benefits. Also, the legislation provides that no regulations relating to the treatment of fringe benefits can be proposed which would be effective prior to expiration of the moratorium.

Reasons for Change

The legislative history of the fringe-benefit moratorium reflects an intent that the Internal Revenue Service should not in any significant way alter, or deviate from, the historic treatment of traditional fringe benefits through the issuance of revenue rulings, revenue procedures, etc.

The committee understands that, prior to 1978, court cases had upheld the Internal Revenue Service in taxing the value of housing that is provided by an employer at below fair market value to an employee. However, in light of the extension through 1983 of the moratorium on changes in the taxation of fringe benefits, the committee believes that it is appropriate to defer through that date any Congressional consideration of whether the value of certain on-campus housing provided at full, direct cost to employees of educational institutions should receive different treatment under the tax law. The provision in the bill, of course, only relates to employee housing meeting the specific conditions of the bill and is not to be interpreted as questioning the correctness of those court cases in any other circumstances.

Explanation of Provision

The bill amends the 1978 statute which first enacted the fringe benefit moratorium (P.L. 95-427), effective for all taxable periods beginning before January 1, 1984.

Under the bill, the legislative moratorium will be construed to preclude the assessment of Federal income taxes or employment taxes with respect to the value of certain lodging provided to an

employee (or the employee's family) by or on behalf of an educational institution described in Code sec. 170(b)(1(A)(ii) (including a university, college, or secondary school). The provision applies if (1) the lodging is located on a campus of, or in proximity of, the institution and (2) the institution receives a reasonable rent that is not less than the necessary direct costs paid or incurred by the institution in providing the lodging. The fact that the rent received by the institution is less than the fair rental value of the lodging provided will not, by itself, preclude the rent from being a reasonable rent. In determining whether a reasonable rent is charged the following types of factors will be taken into account: (1) the necessary direct costs of the institution in furnishing the lodging, (2) the value to the employee, and (3) any educational purposes of the institution in furnishing the lodging.

The bill provides a special rule where the rent received by an educational institution is less than the necessary direct costs paid or incurred by the institution in providing the lodging. In that case, only the excess of the amount of such necessary direct costs over the rent received with respect to the lodging is to be taken into account for purposes of Federal income or employment taxes.

Effective Date

The provision is effective upon date of enactment.

Revenue Effect

The provision will reduce budget receipts by less than $5 million annually.

E. Incentives for Enterprise Zones (secs. 101–181 of the bill, new secs. 44H and 7871 of the Code, secs. 46, 48, 103, 168, 1201, and 1202 of the Code, sec. 601 and new sec. 611 of Title 5 of the United States Code, and the Acts of June 18, 1934 and August 1, 1914)

Present Law

Targeted jobs credit

The targeted jobs tax credit, which applies to wages paid to eligible individuals who begin work for the employer before January 1, 1985, is available on an elective basis for hiring individuals from one or more of 10 target groups. The target groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 through 24, (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) AFDC recipients and WIN registrants; (9) involuntarily terminated CETA employees (this category is terminated effective for individuals who begin work for the employer after December 31, 1982); and (10) disadvantaged youth aged 16 or 17 for summer employment (effective for those who begin work for an employer after April 30, 1983).

The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. The employer's deduction for wages, however, must be reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program.

For purposes of determining the years of employment of an employee and whether the $6,000 cap has been reached with respect to any employee, all employees of any corporation that are members of a controlled group of corporations are treated as if they are employees of a single corporation. Under the controlled group rules, the amount of credit allowed to the group is generally the same which would be allowed if the group were a single company. Comparable rules are provided for partnerships, proprietorships,

and other trades or business (whether or not incorporated) under common control.

The credit may not exceed 90 percent of the employer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward fifteen years.

Investment tax credit

Under present law, a regular investment tax credit is allowed for investment in tangible personal property and other tangible property (generally not including buildings or structural components) used in connection with manufacturing, production, or certain other activities. For eligible property in the 3-year recovery class, a 6-percent regular credit is allowed. For other eligible property, a 10-percent regular credit is allowed.

Buildings and their structural components (other than elevators and escalators) generally do not qualify for the regular investment credit. However, in the case of qualified rehabilitation expenditures, a 15-percent credit is allowed for nonresidential buildings at least 30 years old, a 20-percent credit is allowed for nonresidential buildings at least 40 years old, and a 25-percent credit is allowed for certified historic buildings. The rehabilitation credit is allowed only for property that otherwise is not eligible for the investment credit. Unused investment credits may be carried back 3 years and carried forward for 15 years.

The basis of the asset, for such purposes as capital cost recovery deductions, is reduced by the full amount of the 15-percent or 20-percent credit and by half the investment credit for other types of property.

Capital gains taxation

In general

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. For this purpose, the term "capital asset" generally means any property held by the taxpayer. However, capital assets generally do not include (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, gains from sales or exchanges of certain depreciable or real property used in the taxpayer's trade or business may be treated as capital gains under certain circumstances.

Noncorporate capital gains deduction

Noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a noncorporate taxpayer's entire net capital gain is 20 percent, i.e.,

50 percent (the highest individual tax rate) times the 40 percent of the entire net capital gain includible in adjusted gross income.

Corporate capital gains tax

An alternative tax rate of 28 percent applies to a corporation's net capital gain (the excess of net long-term capital gain over net short-term capital loss) if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Minimum taxes

"Add-on" minimum tax

Present law imposes an "add-on" minimum tax on certain specified tax preference items: 18/46ths of a corporation's net capital gain is a tax preference subject to the minimum tax.

Alternative minimum tax

Under present law, an alternative minimum tax is payable by noncorporate taxpayers to the extent that it exceeds their regular income tax. The alternative minimum tax is based on the sum of the taxpayer's adjusted gross income, reduced by allowed deductions, and increased by tax preference items, including the 60 percent of long-term capital gains deducted in computing the regular tax. The alternative minimum tax rate after 1982 is 20 percent for amounts in excess of an exemption.

Industrial development bonds

Interest on State and local government obligations generally is exempt from Federal income tax (obligations issued after 1982 must be in registered form to be exempt). However, subject to certain exceptions, interest on State and local issues of industrial development bonds is taxable. An obligation constitutes an industrial development bond (IDB) if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization described in sec. 501(c)(3) and (2) payment of principal or interest on which is secured by an interest in, or derived from payments with respect to, property or borrowed money used, or to be used, in a trade or business.

Present law provides an exception which exempts from tax interest on IDBs that are issued to finance the following types of exempt activities: (1) projects for low-income residential rental property, (2) sports facilities, (3) convention or trade show facilities, (4) airports, docks, wharves, mass commuting facilities, and parking facilities, (5) sewage and solid waste disposal facilities, and facilities for the local furnishing of electricity or gas, (6) air or water pollution control facilities, (7) certain for the furnishing of water, (8) qualified hydroelectric generating facilities, and (9) qualified mass commuting vehicles. In addition, the interest on certain IDBs issued for the purpose of acquiring or developing land as a site for an industrial park is exempt from taxation.

Present law also provides an exception for certain "small issues" to the general rule of taxability of interest paid on industrial devel-

opment bonds. This exception is not available for bond proceeds used for golf courses, country clubs, racetracks and other specified types of facilities. This exception applies to issues of $1 million or less if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property.

At the election of the issuer, the $1 million limitation may be increased to $10 million. If this election is made, the exception is restricted to projects where the aggregate amount of outstanding exempt small issues and capital expenditures (financed otherwise than out of the proceeds of exempt small issues) made over or a six-year period does not exceed $10 million. Both the $1 million and $10 million limitations are determined by aggregating the face amount of all outstanding related issues, plus, in the case of the $10 million limitation, certain capital expenditures for all facilities used by the same or related principal users which are located within the same county or same incorporated municipality.

In general, the small issue exemption will not apply with respect to obligations issued after December 31, 1986.

Under present law, to the extent that certain facilities are financed by an IDB and the property is placed in service after December 31, 1982, such property generally is allowed cost recovery deductions at a slower rate than those allowed under ACRS or other accelerated cost recovery provisions of the Code. In lieu of deductions under ACRS, the cost of property financed with IDBs must be recovered using the straight-line method over the ACRS life for the property involved. This limitation applies to both the first owner of the property and to any subsequent owners who acquire the property while the IDBs (including any refunding issues) are outstanding.

However, the cost of certain types of facilities financed in whole or in part with IDBs may continue to be recovered under ACRS: low-income rental housing, municipal sewage and solid waste disposal facilities, air or water pollution control facilities used in connection with a plant or other property in operation before July 1, 1982, and facilities for which a UDAG grant equalling or exceeding 5 percent of the total capital expenditures on the facility is made.

Regulatory flexibility

The Regulatory Flexibility Act (5 USC secs. 602–612) requires Federal regulatory agencies to publish analyses of the economic impact on entities under its coverage of any proposed regulations and to discuss alternatives to those regulations. The Act requires Federal regulatory agencies to undertake a periodic review of their regulations to determine whether they should be changed to minimize their economic impact on the entities covered by the Act.

In general, the purpose of the Regulatory Flexibility Act is to require Federal agencies to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this goal, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration. The Act requires that special attention is to be given to small entities. For example, in its

initial regulatory flexibility analysis, an agency must describe the impact of a proposed rule on small entities.

Small entities, for purposes of the Regulatory Flexibility Act, are small businesses (generally independently owned and operated business enterprises that are not dominant in their fields of operation), small organizations (independently owned and operated not-for-profit enterprises that are not dominant in their fields), and small governmental jurisdictions (governments of cities, towns, townships, villages, school districts, or special districts, with populations of less than fifty thousand).

Foreign trade zones

Under present law, each port of entry is entitled to at least one foreign trade zone. In a foreign trade zone, foreign merchandise may be received by a company, and the merchandise is not considered to have entered U.S. Customs territory. Thus, dutiable goods may be received free of duty. These goods may be stored, sold, repaired, assembled, distributed, manufactured and displayed within the zone, and then exported or sent into Customs territory of the United States. When sent into Customs territory they become subject to the laws affecting imported merchandise, such as the levy of customs duties.

Foreign trade zones are authorized by the Foreign Trade Zone Board, a Federal agency chaired by the Secretary of Commerce. Such zones typically consist of specific factories, warehouses, or industrial parks.

Reasons for Change

A dynamic economy constantly experiences change. Markets shift, companies expand and decline, and there are changes in the composition of consumer products and in the combination of labor, materials, and plant and equipment used in production. In a country as large and diverse as the United States, industrial change also means geographic change—movement among the major regions, from rural to urban areas, and from central city to suburbs. Unless mobile or failed businesses are replaced by new enterprises, local areas decay, and unemployment tends to become endemic.

Most Federal Government programs directed at the unemployed and distressed local areas have been directed at alleviating the burdens on the individuals and communities. Generally, the belief has been that alleviation and basic support would suffice until economic activity in these areas was revived.

Some programs to stimulate local enterprise and farming have been put into effect, and loans have been made available through the Small Business Administration and Farmers Home Administration. In addition, grants to local governments have been made so that they can initiate community development programs that would stimulate local business.

Federal, State and local government resources, however, have not been adequate to overcome the inertia of distress, and a new approach has been developed that will place primary emphasis on the abilities of private enterprise to create employment and economic activity. The keynote of this program is to select a limited

number of distressed urban and rural areas in which private enterprise could expand after being relieved of as much government restraint as possible. These new areas are called enterprise zones, and they are in part modeled after the free trade zones that stimulate international trade in various parts of the world.

Consequently, the establishment of enterprise zones is designed to create jobs in depressed areas, with an emphasis on jobs for disadvantaged workers, and also to redevelop and revitalize these geographic areas themselves.

The intent of the program is to create a freer environment in which new businesses can start and prosper. The target is to stimulate business that would not have been started anywhere else rather than to encourage relocations of existing businesses. Instead, it is intended that the market will decide what activities should take place in the enterprise zones.

Federal participation in creating the new economic environment will take the form of designating the eligible areas and providing various tax benefits: investment credits in addition to those already available; employment credits; and relief from capital gains taxation for gains due to enterprise zone activity. In addition, Federal regulatory agencies will be encouraged to reduce the restraints of their regulatory processes to the maximum reasonable extent.

Local and State governments will be required, when nominating local areas for designation as enterprise zones, to make commitments such as reductions or relief from taxes or regulatory burdens, or to increase the scope or amount of governmental services. Local private organizations also are encouraged to make commitments to foster the success of enterprise zones; these activities may include provision of services to the zones which ordinarily are considered as part of the local government's jurisdiction.

Thus, the enterprise zone concept involves the commitment of Federal, State and local governments and local private organizations to create a freer economic environment in which new private business may prosper in depressed areas.

The Committee on Finance believes that the provisions of this bill will successfully implement these significant and innovative ideas on an experimental basis.

Explanation of Provisions

1. Designation of enterprise zones

The bill amends the Internal Revenue Code to provide criteria for the designation of enterprise zones.

Nomination and designation of enterprise zones

Under the bill, an enterprise zone is any area in the United States or its possessions which is nominated as an enterprise zone by one or more local governments and the government of the State or States in which it is located, and which is approved by the Secretary of Housing and Urban Development (Secretary) after consultation with the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administra-

tion. In the case of an enterprise zone on an Indian reservation, the Secretary of the Interior must be consulted.

For this purpose, the term "State" includes Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, and the possessions of the United States.

Before designating any area as an enterprise zone, the Secretary of HUD must promulgate regulations, drawn up after consultation with the above federal officials, describing (1) the nominating procedures, (2) the size and population characteristics of an enterprise zone, and (3) the procedures for comparing nominated areas using the criteria specified below for evaluating commitments made by State and local governments and for establishing priorities to be applied in making designations.

The Secretary can make designations as enterprise zones only during a 36-month period that begins on the later of the first day of the first month after the effective date of the regulations, or July 1, 1983. (The tax benefits described below will be effective no earlier than January 1, 1984.) During each of the three 12-month periods comprising the 36-month period defined above, not more than 25 nominated areas could be designated as enterprise zones.

At least one-third of the zones designated during the 36-month period must be rural. That is, this one-third of the zones must be in areas outside a standard metropolitan statistical area or must be within a jurisdiction or jurisdictions of local government with population of less than 50,000, and found to be rural by the Secretary after consultation with the Secretary of Commerce.

The Secretary cannot designate an area as an enterprise zone until he has received assurances that the nominating State and local governments in which the nominated area is located have the authority to make the nomination, to make commitments with respect to the zone, and to assure that the commitments will be fulfilled. Nomination of an area will have to be submitted in the form, and with the information, required in the Secretary's regulations. The Secretary also must determine that the information submitted with the nomination is reasonably accurate and that no portion of the nominated area is already included in an enterprise zone or an area nominated as an enterprise zone.

In the case of a nomination of an area on an Indian reservation to be an enterprise zone, the reservation governing body, as determined by the Secretary of the Interior, will be deemed to be both the State and local government for the reservation.

Period of effect of designation

Under the bill, any enterprise zone designation will remain in effect from the date of designation to the earliest of December 31 of the calendar year 24 years later, the date stipulated by the State and local governments in their nomination application, or the date the zone designation is revoked by the Secretary. The Secretary can revoke a zone designation if he determines that the State or local government is not substantially complying with the required State or local government commitments.

Area requirements

The Secretary may designate an area nominated as an enterprise zone, only if it meets requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. These requirements are:

a. The area must be within the jurisdiction of the local government seeking the designation and must have a continuous boundary;

b. The most recent census must show that area population is at least 4,000 if the area is included within a standard metropolitan statistical area with 50,000 or more people, or at least 2,500 in areas of smaller population or subject to the one-third rural set-aside described above, or the area would have to be entirely within an Indian reservation (as determined by the Secretary of the Interior);

c. The Secretary must determine that the area is one of pervasive poverty, unemployment, and general distress, and is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974, as in effect on the date of enactment of this bill.[1]

d. At least one of four additional requirements must be satisfied: (1) the average annual rate of unemployment, as determined by the most recently available data from the Bureau of Labor Statistics, is at least 1½ times the average national unemployment rate for the same time period; (2) according to the most recent census data, at least 20 percent of persons are in families with, or are unrelated individuals with, incomes below the official poverty line, in each census tract, minor civil division or census county division for the period to which the data relates; (3) at least 70 percent of the households living in the area have income below 80 percent of the median income of the households of the government designating the area (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974); or (4) the population of the area decreased by 20 percent or more between 1970 and 1980, as derived from census data.

Required State and local government commitments

Under the bill, no area may be designated as an enterprise zone unless the applicable local and State governments agree in writing that during any period during which the area was an enterprise zone, they will follow a course of action designed to reduce the various burdens borne by employers or employees in the area.

A course of action under the commitment may be implemented by the State and local governments and private nongovernmental entities, and may be funded from the proceeds of any Federal program. A course of action within the enterprise zone may include (but will not be limited to) (1) a reduction of tax rates or fees, (2) an

---

[1] Section 119 establishes a program of urban development action grants (UDAG) to severely distressed cities and urban counties to alleviate physical and economic deterioration through reclamation of neighborhoods. The eligibility of a city, or area within a city, generally is based on some or all of the city's or area's poverty rate, age of housing stock, growth in per capita income, growth in population, growth in retailing and manufacturing employment, unemployment rate, and income distribution.

increase in the level or efficiency of local services or experiments with the supply of these services by nongovernmental entities, (3) elimination, reduction or simplification of government requirements, and (4) program involvement by private entities, organizations, neighborhood associations and community groups, particularly from within the nominated zone, including a commitment from these private entities to provide technical, financial, or other assistance to, and jobs or job training for, employers, employees and residents of the area.

Priority of designation

The bill provides criteria for the Secretary to use in evaluating the qualification of areas nominated to be enterprise zones. The Secretary is required to give special preference to those nominated areas to which the strongest and highest quality commitments, described above, have been promised, taking into account the fiscal ability of the nominating governments to provide tax relief. During the evaluation of nominated areas, the Secretary will be required to give a higher evaluation to nominated areas with the following additional characteristics: (1) strongest and highest quality contributions in addition to commitments described above; (2) most effective and enforceable guarantees provided by nominating State and local governments that proposed courses of action will actually be carried out for the duration of the designation; (3) high levels of poverty, unemployment and general distress, particularly areas near concentrations of disadvantaged workers or long-term unemployed individuals and strong likelihood that zone residents who satisfy these criteria will receive jobs in the zone; (4) zone size and location that will stimulate primarily new economic activity and minimize unnecessary Federal tax losses; (5) most substantial commitments by private entities of additional resources and contributions, including creation of new or expanded business activities; and (6) nominated zones which best exhibit such other factors, to be determined by the Secretary, that are consistent with the program's intent and important in minimizing unnecessary loss of Federal tax revenues.

Interaction with other Federal programs

Tax reductions

Any reduction of taxes under any required program of State and local commitments under the enterprise zone program will be disregarded in determining the eligibility of a State or local government for, or the amount or extent of, any assistance or benefits under any law of the United States, including general revenue sharing payments.

For example, under the general revenue sharing program, as authorized by the State and Local Fiscal Assistance Amendments of 1980 (P.L. 96-604), payments are made to local governments under formulas based on various factors, including income tax and total tax collections of the areas. Thus, under the bill, tax reductions attributable to a required commitment to a course of action for an enterprise zone will not be taken into account in calculating the distribution of revenue sharing payments.

Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970

Designation of an enterprise zone will not constitute approval of a Federal or federally assisted program or project as those terms are used in the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. No person displaced from real property located in an area designated as an enterprise zone will, by virtue of that designation have any rights or be entitled to any benefit pursuant to that Act, such as moving expenses, reimbursement or business losses, or provision of replacement housing, as a result of such designation.

2. Tax credit for enterprise zone employment

Under the bill, enterprise zone employers are eligible to claim a tax credit equal to the sum of two parts—(1) an amount based on the increase in annual wages paid to employees working in the zone relative to wages paid to area employees in the period immediately before the area was designated as an enterprise zone, and (2) an amount based on wages paid in the current period to disadvantaged individuals working in the zone. The credit is limited to the taxpayer's tax liability, and unused credit amounts may be carried back for 3 years or carried forward for the longer of 15 years or the remainder of the period during which the enterprise zone designation is in effect.

Qualified wages and qualified employees

The computation of the credit is based on a definition of qualified wages paid to qualified employees.

Under the bill, a qualified employee is any employee 90 percent or more of whose services directly relate to the conduct of the employer's trade or business located in an enterprise zone and who performs at least 50 percent of his service for the employer in an enterprise zone. A qualified employee does not include an employee with respect to whom the employer claims the targeted jobs credit.

Qualified wages generally is defined to include amounts subject to FUTA (Federal Unemployment Tax Act), without regard to any dollar limit. Special rules similar to those used in the targeted jobs credit are provided for wages paid in connection with agricultural and railway labor not covered by FUTA. Qualified wages for any period do not include any amount of federally funded on-the-job training payments the employer receives or is entitled to receive for a qualified employee for the period.

Increased enterprise zone employment

The first part of the credit is equal to 10 percent of the excess of qualified wages paid or incurred during the taxable year to qualified employees in all enterprise zones over base period wages with respect to all zones. However, qualified wages may not be taken into account if they are taken into account in determining the amount of credit based on wages paid to economically disadvantaged individuals.

Base period wages, for any enterprise zone, is the amount of wages which is paid during the 12-month period prior to zone desig-

nation and which would have been qualified wages paid to individuals who would have been qualified employees if the designation had been in effect during this 12-month period. If the employer has no active trade or business in an area for which an enterprise zone designation is in effect for the taxable year for which the credit computation is made, base period wages for that enterprise zone are zero.

Qualified wages taken into account for this portion of the credit may not exceed 2½ times the FUTA wage base in effect for the calendar year ending in the taxable year for which the credit computation is made. This limit is to be used for the computation of base period wages as well as for the computation of current period qualified wages. If the FUTA wage base is increased, from one year to the next, then the amount of base period wages used in computing the credit in the second year must be recomputed to reflect the higher limit on the amount of wages per employee which may be taken into account.

The increased enterprise zone employment portion of the credit will be phased out starting in the taxable year of the taxpayer in which falls the twenty-first anniversary of the enterprise zone designation or, if earlier, the date 4 years before the date the zone designation is to expire. For this taxable year, the credit will be reduced to 7½ percent of qualified wages. The credit will then be reduced by 2½ percentage points for each succeeding year until fully terminated.

Disadvantaged individuals

The second part of the credit is computed with respect to qualified wages paid to qualified employees who are qualified disadvantaged individuals.

This portion of the credit is allowable for a total of seven years with respect to any qualified employee. The credit is 50 percent of qualified wages paid to a qualified economically disadvantaged individual for services performed during the 36-month period beginning the day the individual began work in an enterprise zone for an employer. The credit will then be reduced 10 percentage points during each of the succeeding twelve-month periods, to 40 percent of qualified wages attributable to services rendered in the fourth year, 30 percent of qualified wages attributable to services rendered in the fifth year, 20 percent of qualified wages attributable to services rendered in the sixth year, and 10 percent of qualified wages attributable to services rendered in the seventh year. These time periods do not take into account any period of time during which the individual is unemployed. The credit with respect to any one employee will not be available after the seventh year of employment.

A qualified disadvantaged individual is anyone who is hired during the period an enterprise zone designation is in effect for the area in which the services which qualify the individual as a qualified employee are performed and who is either a member of an economically disadvantaged family or a general assistance or AFDC recipient as defined for purposes of the targeted jobs credit. Thus, in the first alternative, the individual has to be certified by the designated local agency as being a member of a family that had an

income, including the cash value of food stamps, during the 6 months immediately preceding the month in which the determination occurs, which, on an annual basis, is equal to or less than the combined Aid to Families with Dependent Children (AFDC) and food stamp benefits available to a family of the same size with no countable income or resources. This combined benefit amount is computed first by determining the highest amount which would ordinarily be paid under the AFDC program, in the State in which the family resides, to a family of the same size as the family being considered for tax credit eligibility. A family need not be of a type normally eligible for AFDC for the purposes of applying this standard. For example, the tax credit eligibility of a married couple with no children would be determined on the basis of the AFDC payment available to a single parent and one child, even though childless couples are not eligible for AFDC payments. Determinations throughout the entirely of each State are to use the highest benefit amount available in any locality in the State to an assistance unit with no income and resources and with maximum need. The food stamp portion of the combined benefit amount is then to be computed by assuming that the household's only income consists of AFDC benefits in the amount just determined, that the household consists only of the AFDC unit for which the computation is made (e.g., that there are no unrelated individuals living in the household), and that the family is entitled to the standard deduction and the maximum amount of other deductions which are ordinarily allowed to be household, the income of which consists entirely of AFDC benefits.

Alternatively, to be eligible for this portion of the tax credit, the individual must be certified as having been placed in employment under a work incentive program, or as receiving assistance under either the AFDC program for the 90-day period preceding the hiring date or under a general assistance program for not less than 30 days ending within the 60-day period ending on the day the individual is hired by the employer. Only those general assistance programs designated by the Secretary of the Treasury as consisting of money, voucher, or scrip payments based on need are taken into account for this purpose. The Secretary is not to designate any program designed specifically by a State or local government for enterprise zone residents in order to determine eligibility for this credit.

The credit amount is reduced 25 percent in the first year in which the increased employment credit begins to phase out, and this reduction factor is increased by 25 percent each year thereafter.

Other rules

Rules analogous to those contained in the present targeted jobs and research and experimental expenditures tax credits will control certification procedures and allocation and computation of the credit for controlled groups of businesses, for subchapter S corporations and their shareholders, for estate and trusts and their beneficiaries, and for employers affected by acquisitions and dispositions. Special rules also are provided for taxpayers for which a zone designation is in effect only part of the taxable year or with a short taxable year.

Any credit taken with respect to an employee is recaptured if the employee is terminated at any time during the first 270 days after the employee begins work for the employer, with certain exceptions, including voluntary termination, disability, or misconduct of the employee, or substantial reduction of the business. However, if the major portion of a trade or business, or the major portion of a separate unit of a trade or business of an employer is acquired by another employer, then employment of any qualified employee is not terminated for purposes of this credit if the employee continues to be employed in that trade or business.

No deduction is allowable to an enterprise zone employer for that portion of wages paid or incurred for the taxable year equal to the amount of credits allowable under this provision for the taxable year.

3. Investment tax credit for zone property

Under the bill, an additional investment tax credit is allowed for certain capital investments in an enterprise zone.

Zone personal property

In the case of property eligible for the regular investment tax credit (other than elevators and escalators), an additional 3-percent credit is available for 3-year recovery property and an additional 5-percent credit is available for 5-year property, 10-year property, and 15-year public utility property. In order to be eligible for this additional credit, such property must be acquired and first placed in service by the taxpayer in an enterprise zone after designation of the zone. The property does not have to be new property. The taxpayer must use the property predominantly in the active conduct of a trade or business within an enterprise zone and must not acquire the property from a related person. Property used or located outside the enterprise zone on a regular basis is not eligible for the additional credit. In order to facilitate enforcement of this rule, the Secretary may prescribe by regulation that certain types of mobile equipment are ineligible for the credit. The credit rate is reduced by 25 percent in the first year in which the employment credit begins to be phased out, and this reduction factor is increased by 25 percent each year thereafter.

New zone construction property

An additional 10-percent tax credit is available for 15-year real property (including lodging, elevators and escalators) located in an enterprise zone if the property is acquired or constructed by the taxpayer and used predominantly in the active conduct of a trade or business, including rental of real estate, within the enterprise zone. In the case of property acquired by the taxpayer, the additional credit is available only if the property is acquired after designation of the zone and only if the original use of the property commences with the taxpayer. In the case of property constructed, reconstructed, rehabilitated, renovated, expanded, or erected by the taxpayer, the credit is available only to the extent of any construction or erection after designation of the enterprise zone. The credit rate is reduced by 25 percent in the first year in which the employ-

ment credit begins to be phased out, and this reduction factor is increased by 25 percent each year thereafter.

For property eligible for this additional 10-percent tax credit (15-year real property), the basis of the property must be reduced by the full amount of the additional credit allowable.

Recapture

If property for which an enterprise zone credit was claimed by a taxpayer ceases to be enterprise zone property of the taxpayer (other than by expiration or revocation of the designation of the zone), a portion of the enterprise zone credit must be recaptured. Property ceases to be enterprise zone property of a taxpayer if, for example, the taxpayer disposes of the property, removes the property from the enterprise zone, or ceases to use the property in the active conduct of a trade or business within the enterprise zone.

The amount of the enterprise zone credit subject to recapture is the difference between the amount of credit allowed for the property and a recomputed credit based on the amount of time the property was enterprise zone property of the taxpayer. The recomputed credit bears the same ratio to the amount of credit originally allowed as the number of taxable years in which the property was enterprise zone property of the taxpayer bears to the number of years over which the property is depreciated for purposes of computing earnings and profits. The recapture periods would be as follows:

	Years
3-year property	5
5-year property	12
10-year property	25
15-year public utility property	35
15-year real property	35

Thus, for example, no enterprise zone credit will be recaptured with respect to 3-year recovery if it remained enterprise zone property of the taxpayer for 5 taxable years. If this property had been enterprise zone property of the taxpayer for only 4 taxable years, 20 percent of the enterprise zone credit would be recaptured.

Carryover period

Unused investment tax credit amounts attributable to the additional enterprise zone percentage could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

4. Elimination of capital gains taxation

Qualified property and qualified business

The bill provides special tax treatment for gains and losses from sales or exchanges of "qualified property" eligible for long-term capital gain treatment. For this purpose, the term "qualified property" means (1) tangible personal property used predominantly by the taxpayer in an enterprise zone in the active conduct of a trade or business in a zone, (2) real property located in an enterprise zone and which is used predominantly by the taxpayer in the

active conduct of a trade or business in a zone and (3) an interest in a corporation, partnership, or other entity if, for the three most recent taxable years of the entity ending before the date of disposition of the interest, the entity was a "qualified business."

Under the provision, the term "qualified business' means any person (1) actively engaged in the conduct of a trade or business (including rental of real estate) during the three most recent taxable years, (2) with respect to which at least 80 percent of such person's gross receipts for the taxable year are attributable to the active conduct of a trade or business within an enterprise zone, and (3) substantially all of the tangible assets of which are located within an enterprise zone.

Under the bill, gain from the sale or exchange of an interest in a qualified business is not treated as gain from the sale or exchange of qualified property to the extent the gain is attributable to (1) any property contributed to the qualified business within the previous 12 months, (2) any interest in a business which is not a qualified business, (3) any gain allocable to a period when the property is not qualified property, or (4) any other intangible property not properly allocable to an active trade or business within an enterprise zone.

Under the bill, the special tax treatment for gains and losses from sales or exchanges of "qualified property" does not cease to be available subsequent to the termination or revocation of an area's designation as an enterprise zone. However, the special tax treatment does not apply after the first sale or exchange of any item of "qualified property" after the designation of an area as an enterprise zone ceases to apply.

Noncorporate capital gains deduction

The bill provides a special rule for a noncorporate taxpayer's gains and losses from sales or exchanges of qualified property. Under this rule, a noncorporate taxpayer can deduct from gross income an amount equal to the sum of (1) 100 percent of the lesser of the taxpayer's net capital gain, or the net capital gain taking into account only sales or exchanges of qualified property, plus (2) 60 percent of the excess (if any) of the net capital gain over the amount of the net capital gain subject to the 100 percent deduction. This rule, in effect, allows a noncorporate taxpayer to deduct from gross income 100 percent of any net capital gain from qualified property.

Corporate capital gains tax

The bill allows a corporation to exclude from taxation net capital gain from qualified property.

Tax preferences for minimum tax purposes

The bill eliminates the classification of net capital gains from qualified property as a tax preference item for purposes of the minimum taxes.

5. Industrial development bonds

The bill provides that the provision of present law which restricts the cost recovery deductions for property financed with tax-

exempt bonds does not apply to enterprise zone property eligible for the additional investment credit described above.

The bill also provides that the provision of present law which terminates the small issue exception after December 31, 1986, does not apply to any obligation which is part of an issue substantially all of the proceeds of which are used to finance facilities placed in service in an area for which an enterprise zone designation is in effect.

6. Tax simplification

The bill provides that it is the sense of the Congress that the Internal Revenue Service should, in every way possible, simplify the administration and enforcement of the tax provisions added to the Internal Revenue Code by this bill.

7. Regulatory flexibility

Under the bill, Federal agencies and regulatory bodies are given discretionary authority to relax or eliminate any regulatory requirements within enterprise zones except those affecting civil rights, safety and public health, or those required by statute, such as the Davis-Bacon Act or the Fair Labor Standards Act. This authority may be exercised only upon written request of State and local governments.[1] Agencies shall make their determinations on requests not later than 90 days after their receipts. Such waivers or determinations shall not be considered a rule, rulemaking, or regulation under the Administrative Procedures Act.

The bill also expands the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterprise operating within an enterprise zone.

The bill also provides that the Secretary of Housing and Urban Development is required to promote the coordination of programs under his jurisdiction and carried on in an enterprise zone and to consolidate requirements for related applications and reports required under these programs.

8. Establishment of foreign trade zones in enterprise zones

The bill requires that the Foreign Trade Zone Board expedite the processing and approval, to the maximum extent practicable, of any application involving the establishment of a foreign trade zone within an enterprise zone. The Secretary of the Treasury is required to give similar consideration to an application for establishment of a port of entry necessary to permit the establishment of a foreign trade zone within an enterprise zone.

---

[1] Examples of regulations which could be relaxed include regulations governing exports, regulations affecting accounting treatment of loans made by national banks, regulations affecting inventory accounting for tax purposes, regulations affecting issuance of securities, and regulations affecting various energy performance, coal conversion, and conservation regulations.

Effective Date

The provisions relating to designations of enterprise zones, regulatory flexibility and foreign trade zones are effective on the date of enactment.

The provision for a tax credit for enterprise zone employment is effective for taxable years beginning after December 31, 1983.

The extra investment tax credit for enterprise zone property is effective for periods after December 31, 1983, under rules similar to section 48(m) of the Internal Revenue Code.

The provisions eliminating capital gains taxation are effective for sales or exchanges after December 31, 1983.

The provisions related to industrial development bonds apply to obligations issued after December 31, 1983, in taxable years ending after such date.

Revenue Effect

The effect of the enterprise zone provisions on budget receipts will depend on the number, size, and characteristics of the zones designated by the Secretary of Housing and Urban Development. Because the bill provides the Secretary with wide latitude in his choice, the committee is unable to provide specific cost estimates for these provisions.

The Treasury Department estimates that these provisions will reduce fiscal year receipts by $98 million in 1984, $320 million in 1985, $584 million in 1986, $770 million in 1987 and $877 million in 1988. These estimates are based on particular assumptions about the size and characteristics of the zones. However, these assumptions are not mandated by the provisions of this bill, and thus, these figures may either underestimate or overestimate the actual revenue loss by a considerable degree.

Treasury's estimates are based on the assumption that the zones selected by the Secretary of Housing and Urban Development would have, at the time of designation, average employment, other than in governments and non-profit institutions, of 8,000 and a mix of economic activities similar to those of a sample of distressed areas in several large cities. The language of the bill does not require this average employment and economic mix, however, so that the above figures may not estimate the actual revenue loss. If the average zone has, for example, only 4,000 employees, then actual revenue losses would be $0.05 billion, $0.2 billion, $0.3 billion, $0.4 billion, and $0.4 billion in fiscal years 1984 through 1988, respectively, if the assumptions about the economic mix were correct.

On the other hand, several factors could make the actual revenue loss higher than the Treasury estimates. First, the actual mix of economic activities in the zone or attracted to the zone could be very payroll intensive and have a high ratio of investment to payroll, substantially increasing the cost of the tax incentives relative to what was assumed. Second, the average size of zones when they are actually designated by the Secretary could be much larger than 10,000. If, for example, employment in designated zones were to average 40,000 and the economic mix were the same as assumed by Treasury, fiscal year revenue losses would be $0.5 billion in 1984, $1.6 billion in 1985, $2.9 billion in 1986, $3.9 billion in 1987 and $4.4 billion in 1988.

III. COSTS OF CARRYING OUT THE BILL AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

Budget Effects

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the budget effects of H.R. 7094, as reported.

Budget receipts

The table below summarizes the estimates of the effects on budget receipts of the provisions of the bill for fiscal years 1983-1987:

(Fiscal years; Millions of dollars)

Provision	1983	1984	1985	1986	1987
Excise tax on failures to comply with certain pension plan determination letters	(1)	(1)	(1)	(1)	(1)
Rollover of qualified distributions	(1)	(1)	(1)	(1)	(1)
Treatment amounts received in Westinghouse litigation settlement	(2)	(2)	(2)	(2)	(2)
Treatment of employer-supplied faculty housing	(3)	(3)	(3)	(3)	(3)
Tax incentives for enterprise zones		(3)	(3)	(3)	(3)

[1] Negligible.
[2] The provision is not estimated to affect budget receipts unless the courts uphold the position taken by the Service. If the Service prevails, receipt reductions attributable to the provision would probably occur in fiscal years after 1987 because of the timing of the audit process and delays of litigation.
[3] Less than $5 million.
[4] The budget effects of this provision will depend on the number, size, and characteristics of the enterprise zones designated by the Secretary of Housing and Urban Development. (see "Revenue Effect" statement in text, Part II. E.)

The Treasury Department agrees with this statement.

Budget outlays

The bill involves no budget outlays.

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 relative to the vote by the committee, on the motion to report the bill. H.R. 7094, as amended, was ordered favorably reported by voice vote.

IV. REGULATORY IMPACT OF THE BILL AND OTHER MATTERS TO BE DISCUSSED UNDER SENATE RULES

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 H.R. 7094, as reported.

Numbers of individuals and businesses who would be regulated

The bill does not generally involve new or expanded regulation of individuals or businesses. The bill does provide a new excise tax sanction on multiemployer pension plan trustees or administrators who violate an independent asset management condition in a determination letter issued before September 15, 1982, if the plan agreed to the condition in writing before that date.

Economic impact of regulation on individuals, consumers, and business

The bill provides for an excise tax on failures to adhere to conditions of determination letters relating to independent management of the assets of multiemployer pension plans, relief for John W. Pope relating to rollover of qualifying distributions to an IRA, treatment of amounts received in settlement of Westinghouse uranium litigation, treatment of employer-provided faculty housing, and enterprise zone incentives.

Impact on personal privacy

The bill does not relate to the personal privacy of individuals.

Determination of the amount of paperwork

The bill will involve some additional paperwork for taxpayers qualifying for the enterprise zone incentives. Additional paperwork will be required for taxpayers to maintain records of enterprise zone employment and investment, and to keep the information required for the calculation of the amount of capital gains exempt from tax. The Internal Revenue Service is directed by the bill to simplify as much as is possible the enterprise zone tax provisions added to the Internal Revenue Code.

B. Other Matters

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 of the tax provisions of

the bill (as shown in Part III of this report) and agrees with the methodology used and committee's budget estimates.

New budget authority

In compliance with section 308(a)(1) of the Budget Act, and after consultation with the Director of the Congressional Budget Office the committee states that the changes made to existing law by the bill involves no new budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act with respect to tax expenditures, and after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by the bill involve new and increased tax expenditures of an indeterminate amount relating to tax incentives for enterprise zones (see footnote to table in Part III above for statement).

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 provisions of H.R. 7094, as reported by the committee).