Calendar No. 494

102D CONGRESS
2d Session

SENATE

REPORT
102–300

TAX EXTENSION ACT OF 1992

JUNE 19 (legislative day, JUNE 16), 1992.—Ordered to be printed

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

REPORT

[To accompany H.R. 3040]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance, to which was referred the bill (H.R. 3040) to provide a program of Federal supplemental compensation, and for other purposes, having considered the same, reports favorably thereon with an amendment and an amendment to the title and recommends that the bill as amended do pass.

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59–010

The amendment strikes out all after the enacting clause of the bill and inserts a new text which appears in italic type in the reported bill.

I. Legislative Background

H.R. 3040 was passed by the House of Representatives on September 17, 1991. As passed by the House, the bill provided a program of supplemental Federal unemployment compensation. H.R. 3040 was referred to the Senate Committee on Finance on September 18, 1991. The subject matter of H.R. 3040 was subsequently passed on another bill.

The provisions of the Committee amendment to H.R. 3040 as reported by the Committee on Finance generally were previously included (except for the corporate estimated tax provision), with modifications, in H.R. 4210 as passed by the House and Senate and vetoed by the President.[1]

II. Explanation of Provisions

Title I. Extension of Certain Expiring Tax Provisions

1. EXTENSION OF EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE (SEC. 101 OF THE BILL AND SEC. 127 OF THE CODE)

Present law

An employee's gross income and wages for income and employment tax purposes do not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts are paid or incurred pursuant to an educational assistance program that meets certain requirements. This exclusion,

[1] See Committee on Finance, *Technical Explanation of the Senate Finance Committee Amendment to H.R. 4210 With Minority Views* (S. Prt. 102-77), March 6, 1992. Also, Conference Report on H.R. 4210 (H. Rept. 102-461), March 20, 1992.

which expires with respect to amounts paid after June 30, 1992, is limited to $5,250 of educational assistance with respect to an individual during a calendar year.

In the absence of this exclusion, an employee generally would be required to include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to the employee, unless the cost of such assistance qualified as a deductible job-related expense of the employee.

Reasons for change

The exclusion from income for employer-provided educational assistance programs has two intended purposes: (1) to increase the levels of education and training in the workforce and (2) to eliminate the potential complexity of determining whether training and education benefits provided by an employer constitute job-related expenses that are deductible by the employee.

The committee believes that some of the benefits attributable to the exclusion for employer-provided educational assistance accrue to society at large by creating a better-educated workforce. The committee believes that the exclusion for employer-provided educational assistance is used by employees to improve their competitive position in the workforce. In the absence of the subsidy, the committee believes that some individuals would underinvest in education.

The committee believes it is appropriate to provide for a temporary extension of the exclusion to reduce the complexity that would exist in the absence of the exclusion and to provide the opportunity for Congress to reevaluate the value of the exclusion.

Explanation of provision

The exclusion for employer-provided educational assistance is extended for 18 months (through December 31, 1993).

Effective date

The provision is effective for taxable years ending after June 30, 1992.

2. EXCLUSION FOR EMPLOYER-PROVIDED GROUP LEGAL SERVICES; TAX EXEMPTION FOR QUALIFIED GROUP LEGAL SERVICES ORGANIZATIONS (SEC. 102 OF THE BILL AND SECS. 120 AND 501(C)(20) OF THE CODE)

Present law

Certain amounts contributed by an employer to and benefits provided under a qualified group legal services plan are excluded from an employee's gross income and wages for income and employment tax purposes. The exclusion is limited to an annual premium value of $70. The exclusion expires after June 30, 1992.

Present law provides tax-exempt status for an organization the exclusive function of which is to provide legal services or indemnification against the cost of legal services as part of a qualified group legal services plan. The tax exemption for such an organization expires after June 30, 1992.

Reasons for change

The committee believes that the exclusion for employer-provided group legal services and the tax exemption for group legal services organizations may increase the access of taxpayers to basic legal services.

Although there is inadequate evidence to draw an unequivocal conclusion that the favorable tax treatment received by employer-provided group legal services is justified by the benefits to society of increased access to legal services, the committee believes it is appropriate to provide for a temporary extension of the exclusion and exemption to provide the opportunity for Congress to reevaluate the value of the exclusion and exemption.

Explanation of provision

Under the bill, the exclusion from income for employer-provided group legal services and the tax exemption for group legal services organizations is extended for 18 months (through December 31, 1993).

Effective date

The provision is effective for taxable years ending after June 30, 1992.

3. EXTEND HEALTH INSURANCE DEDUCTION FOR SELF-EMPLOYED INDIVIDUALS (SEC. 103 OF THE BILL AND SEC. 162(l) OF THE CODE)

Present law

Under present law, the tax treatment of health insurance expenses depends on whether the taxpayer is an employee and whether the taxpayer is covered under a health plan paid for by the employee's employer. An employer's contribution to a plan providing accident or health coverage for the employee and the employee's spouse and dependents is excludable from an employee's income. In addition, businesses can generally deduct, as an employee compensation expense, the full cost of any health insurance coverage provided for their employees. The exclusion and deduction are generally available in the case of owners of the business who are also employees.

In the case of self-employed individuals (i.e., sole proprietors or partners in a partnership) no equivalent exclusion applies. However, present law provides a deduction for 25 percent of the amount paid for health insurance for a self-employed individual and the individual's spouse and dependents. The 25-percent deduction is also available to more than 2-percent shareholders of S corporations. The amount of expenses in excess of the deductible amount can be taken into account in determining whether the individual is entitled to a medical expense deduction (sec. 213). Thus, such amounts are deductible to the extent that, when combined with other unreimbursed medical expenses, they exceed 7.5 percent of adjusted gross income.

Other individuals who purchase their own health insurance can deduct their insurance premiums only to the extent that the premiums, when combined with other unreimbursed medical expenses, exceed 7.5 percent of adjusted gross income.

The 25-percent deduction is scheduled to expire for taxable years beginning after June 30, 1992. In the case of years beginning in 1992, only amounts paid before July 1, 1992, for coverage before July 1, 1992, are taken into account in determining the amount of the deduction.

Reason for change

The 25-percent deduction for health insurance costs of self-employed individuals was added by the Tax Reform Act of 1986 to reduce the disparity between the tax treatment of owners of incorporated and unincorporated businesses (e.g., partnerships and sole proprietorships). The provision was enacted on a temporary basis, and has been extended several times since enactment.

In H.R. 4210, as passed by the Senate earlier this year, the committee provided for a permanent extension of the exclusion of 100 percent of the health insurance expenses of self-employed individuals. However, this provision has not been enacted. Given the short time until the 25-percent deduction will expire, the committee believes that it is appropriate at this time to extend the provision providing a 25-percent deduction again on a temporary basis.

Explanation of provision

The bill extends the 25-percent deduction for health insurance expenses of self-employed individuals for 18 months (through December 31, 1993).

Effective date

The provision is effective for taxable years ending after June 30, 1992.

4. QUALIFIED MORTGAGE BONDS AND MORTGAGE CREDIT CERTIFICATES (SEC. 104 OF THE BILL AND SECS. 143 AND 25 OF THE CODE)

Present law

Qualified mortgage bonds

Qualified mortgage bonds ("QMBs") are bonds the proceeds of which are used to finance the purchase, or qualifying rehabilitation or improvement of single-family, owner-occupied residences located within the jurisdiction of the issuer of the bonds. Persons receiving QMB loans must satisfy principal residence, purchase price, borrower income, first-time homebuyer, and other requirements. Part or all of the interest subsidy provided by QMBs is recaptured if the borrower experiences substantial increases in income and disposes of the subsidized residence within nine years after it was purchased.

The volume of QMBs that a State may issue is limited by an annual State private activity bond volume limit.

Mortgage credit certificates

Qualified governmental units may elect to exchange private activity bond volume authority for authority to issue mortgage credit certificates ("MCCs"). MCCs entitle home-buyers to nonrefundable income tax credits for a specified percentage of the interest paid on mortgage loans on their principal residences. Once issued, an MCC remains in effect as long as the loan remains outstanding and the residence being financed continues to be the MCC-recipient's principal residence. MCCs are subject to the same targeting requirements and recapture rules as QMBS.

Expiration

Authority to issue QMBs and to elect to trade in private activity bond volume authority to issue MCCs is scheduled to expire after June 30, 1992.

Reasons for change

If properly targeted and administered, the QMB and MCC programs should enable the individuals to who otherwise would be unable to afford homes without the longer-term Federal subsidy provided by these programs. A temporary extension of the programs will permit this assistance to continue while also facilitating continued Congressional oversight of the effectiveness of the programs.

The committee has become aware that some states have housing programs that are designed to aid very low-income individuals who already have purchased land under a contract for deed. In a contract for deed, the individuals have purchased unimproved land under a type of land installment contract. Then the individuals frequently have constructed housing which does not meet adequate housing standards on that land for use as their principal residence. The committee understands that these contracts for deed must be refinanced in order to obtain financing for construction on the land of a new residence that meets adequate housing standards or a qualified home improvement loan for the existing housing on the land.

Explanation of provision

The bill extends the authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs for 18 months (through December 31, 1993).

The bill also provides, that in the case of homebuyers whose family income does not exceed $15,000,[2] ownership of land subject to certain contracts for deed does not violate the requirement that QMB- and MCC-financed homebuyers be first-time homebuyers and that the financing provided be for new mortgages. Thus, the bill allows QMB-financed loans to be made (and MCCs granted) to individuals who own land subject to these contracts for deed provided that the homebuyers satisfy (a) all otherwise applicable requirements of the QMB and MCC programs but for the contract for deed and (b) the special $15,000 income limit. These loans may be used to repay the contract for deed and to finance a new residence on the land. Also, as under present law, these homebuyers will remain

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[2] This $15,000 amount will be indexed for calendar years after 1992, by the same percentage as the annual percentage change in the applicable area median family income for the area in which the land and residence are located.

eligible for qualified home improvement loans to rehabilitate existing housing on the land subject to the contracts for deed.

Effective date

The extension of the QMB and MCC programs is effective after June 30, 1992. The provision relating to land owned subject to certain contracts for deed applies to loans made (and MCCs granted) after the date of the bill's enactment.

5. QUALIFIED SMALL-ISSUE BONDS (SEC. 105 OF THE BILL AND SEC 144 OF THE CODE)

Present law

Interest on small issues of private activity bonds issued by States or local governments ("qualified small-issue bonds") is excluded from gross income if certain conditions are met. First, at least 95 percent of the bond proceeds must be used to finance manufacturing facilities or certain agricultural land or equipment. Second, the bond issue must have an aggregate amount of $1 million or less, or the aggregate amount of the issue, together with the aggregate amount certain related capital expenditures during the six-year period beginning three years before the date of the issue and ending three years after that date, may not exceed $10 million.

Issuance of qualified small-issue bonds, like most other private activity bonds is subject to annual State volume limitations.

Authority to issue qualified small-issue bonds is scheduled to expire after June 30, 1992.

Reasons for change

The committee believes that it is appropriate to permit State and local governments to continue to issue qualified small-issue bonds.

Explanation of provision

The bill extends authority to issue qualified small-issue bonds for 18 months (through December 31, 1993).

Effective Date

The provision is effective for bonds issued after June 30, 1992.

6. RESEARCH AND EXPERIMENTATION TAX CREDIT (SEC. 106 OF THE BILL AND SEC. 41 OF THE CODE)

Present law

A 20-percent tax credit is allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit will not apply to amounts paid or incurred after June 30, 1992.

The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (such as "start-up" firms) are assigned a fixed-base percentage of .03.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

Qualified research expenditures eligible for the credit consist of: (1) "in-house" expenses of the taxpayer for research wages and supplies used in research; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf. Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

In addition, the 20-percent tax credit also applies to the *excess* of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research *over* (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

Deductions for qualified research expenditures allowed to a taxpayer under section 174 are reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

Reasons for change

Technological development is an important component of economic growth. However, businesses may not find it profitable to invest in some research activities, because it is difficult to capture the full benefits from the research. (Costly technological advances made by one firm are often cheaply copied by its competitors.) A research credit can help to promote investment in research, so that research activities undertaken approach the optimal level for the overall economy. The committee, therefore, believes that it is appropriate to extend the research tax credit.

Explanation of provision

The bill extends the research tax credit for 18 months (i.e., for qualified research expenditures and university basic research expenditures incurred through December 31, 1993).

Effective date

The provision applies to qualified expenditures incurred during the period July 1, 1992, through December 31, 1993.

7. TAX CREDIT FOR LOW-INCOME RENTAL HOUSING TAX CREDIT (SEC. 107 OF THE BILL AND SEC. 42 OF THE CODE)

Present law

In general

A tax credit is allowed in annual installments over 10 years for qualifying newly constructed or substantially rehabilitated low-income rental housing. For most qualifying housing, the maximum credit is an amount having a present value of 70 percent of the eligible basis of the low-income housing units. For housing receiving other Federal subsidies (e.g., tax-exempt bond financing) and for the acquisition cost of existing housing that is substantially rehabilitated (e.g., costs other than rehabilitation expenditures), the maximum credit is an amount having a present value of 30 percent of qualified basis. Generally, that part of the building for which the credit is claimed must be rented to qualified low-income tenants at restricted rents for 15 years after the building is placed in service. In addition, a subsequent additional 15-year period of low-income use generally is required.

Eligible basis

The basis on which the credit is computed is determined as a percentage of the eligible basis of a qualified low-income building that is attributable to low-income rental housing units. This percentage is the lesser of (1) the percentage of low-income units to all residential units or (2) the percentage of the floor space of the low-income units to the floor space of all residential rental units. Generally, eligible basis is limited to the adjusted basis of the residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project. There is no per-housing unit limit on the amount of eligible basis.

Ten-year anti-churning rule

The credit is not allowed on buildings, or substantial improvements to buildings, that have been previously placed in service within 10 years of placement in service for credit purposes. Waivers from the 10-year rule may be granted by the Treasury Department under certain circumstances.

Minimum set-aside requirement for low-income individuals

Under the general minimum set-aside a residential rental project qualifies for the credit only if: (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 50 percent or less of area median income or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of area median income. Also, a special set-aside may be elected for projects that satisfy a stricter requirement and that significantly restrict the rents on the low-income units relative to the other residential units in the building.

Students

A housing unit generally is not eligible for the low-income housing tax credit if the tenants are full-time students who are not married individuals filing joint returns. Exceptions to this rule allow the credit to be claimed on housing units occupied by persons who are enrolled in certain job training programs or students who are receiving AFDC payments.

State low-income housing credit authority limitation

Each State receives an annual low-income housing credit volume ceiling of $1.25 per resident. To qualify for the credit, a building owner generally must receive a credit allocation from the appropriate State credit authority. An exception is provided for property which is substantially financed with the proceeds of tax-exempt bonds subject to the State's private-activity bond volume limitation.

That portion of a State's credit authority which is unallocated in the year in which it originally arises may be carried forward and added to the State's credit authority for the subsequent calendar year. If allocations in the subsequent year exceed that year's annual credit authority, but do not exhaust the sum of that year's annual credit authority plus any credit authority carried forward from the preceding year, any remaining carried-forward credit authority is allocated in the next subsequent year to a national pool.

Expiration

The low-income housing credit is scheduled to expire after June 30, 1992.

Reasons for change

The committee believes it is appropriate for the Federal Government to play a significant role in the development of additional affordable housing for low-income individuals. The committee believes that the low-income housing tax credit is a useful incentive for increasing the housing stock available to these individuals. Further, the committee believes that the modifications to the credit will improve its operation.

Explanation of provision

Expiration

The bill extends the low-income housing tax credit for 18 months (through December 31, 1993), with several modifications.

Eligible basis

The bill makes two changes to the eligible basis rules:

First, the eligible basis of each unit in a credit project is limited to an amount equal to the maximum FHA single family insurance amount (currently $124,875). This amount would be indexed for inflation. In high-cost areas this maximum basis amount would be increased to 130 percent of the otherwise allowable maximum amount.

Second, the bill provides that community service facilities in projects in qualified census tracts are included in eligible basis as functionally related and subordinate facilities if (a) the size of the facilities is commensurate with tenant needs, (b) the use of the facilities is predominantly (although not exclusively) used by the tenants and employees of the project owner, and (c) no more than 20 percent of the credit project's eligible basis is attributable to such facilities.

10-year anti-churning rule

The bill authorizes the Treasury Department to grant waivers from the credit's 10-year anti-churning rule for certain projects substantially assisted, financed, or operated under section 221(d)(4) of the National Housing Act.

Minimum set-aside requirement for low-income individuals

The bill authorizes the Treasury Department to: (1) provide a waiver of penalties for de minimis errors in the application of the minimum set-aside rules, and (2) grant a waiver from the annual recertification of tenant income, for tenants in a building, if all the tenants in the building are low-income tenants.

Students

The bill provides that a unit occupied entirely by full-time students may qualify for the credit if the full-time students are a single parent and his or her minor children and none of the tenants is a dependent of a third party. The bill also codifies the present-law exception regarding married students filing joint returns (which continues to apply to all buildings placed in service since original enactment of the low-income housing credit by the Tax Reform Act of 1986.)

State low-income housing credit authority limitation

For purposes of the carryforward rule, the bill treats credits carried forward from previous years as used before current year credits.

Effective date

Generally, the provision is effective for allocations of low-income housing credit volume limitation (and bond-financed buildings financed with tax-exempt bonds issued) after June 30, 1992. The provisions relating to the Treasury Department's authority to grant waivers are effective on date of enactment. The provision relating to the credit carryforward rules is effective on or after January 1, 1992.

8. TARGETED JOBS TAX CREDIT (SEC. 108 OF THE BILL AND SEC. 51 OF THE CODE)

Present law

Tax credit

The targeted jobs tax credit is available on an elective basis for hiring individuals from nine targeted groups. These targeted groups consist of individuals who are either recipients of payments under means-tested programs, economically disadvantaged (as measured by family income), or disabled.

The credit generally is equal to 40 percent of up to $6,000 of qualified first-year wages. A credit equal to 40 percent of up to $3,000 of wages paid to qualified summer youth employees is also allowed. Thus, the maximum credit is generally $2,400 per qualified employee, with a $1,200 maximum credit per summer youth employee. The employer's deduction for wages is reduced by the amount of the credit claimed.

The credit is scheduled to expire for individuals who begin work for an employer after June 30, 1992.

Authorization of appropriations

Present law authorizes appropriations for administration and publicity expenses relating to the credit through June 30, 1992. These monies are to be used by the Internal Revenue Service and the Department of Labor to inform employers of the credit program.

Reasons for change

The committee believes that the targeted jobs tax credit provides a useful incentive for hiring disadvantaged individuals. The committee also believes that economically disadvantaged youths aged 23 and 24 will enjoy increased employment opportunities with the extension to them of the credit.

Explanation of provision

The bill extends the targeted jobs tax credit and the authorization for appropriations for 18 months (through December 31, 1993). The bill also restores individuals aged 23 and 24 to the category of economically disadvantaged youth.

Effective date

The provision is effective for individuals who begin work for an employer after June 30, 1992.

9. TAX CREDIT FOR ORPHAN DRUG CLINICAL TESTING EXPENSES (SEC. 109 OF THE BILL AND SEC. 28 OF THE CODE)

Present law

A 50-percent nonrefundable tax credit is allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA. Present law defines a rare disease or condition as one that (1) affects less than 200,000 persons in the United States or (2) affects more than 200,000 persons, but there is no reasonable expectation that businesses could recoup the costs of developing a drug for it from U.S. sales of the drug. These rare diseases and conditions include Huntington's disease, myoclonus, ALS (Lou Gehrig's disease), Tourette's syndrome, and Duchenne's dystrophy (a form of muscular dystrophy).

The orphan drug tax credit is scheduled to expire after June 30, 1992.

Reasons for change

To encourage the development of drugs to treat rare diseases, the committee believes it is appropriate to extend the orphan drug tax credit.

Explanation of provision

The bill extends the orphan drug tax credit for 18 months (i.e., for qualified clinical testing expenses incurred through December 31, 1993).

Effective date

The provision is effective for expenses incurred during the period July 1, 1992, through December 31, 1993.

10. CONTRIBUTIONS OF APPRECIATED PROPERTY FOR AMT PURPOSES (SEC. 110 OF THE BILL AND SEC. 57(a)(6) OF THE CODE)

Present law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair-market value of property contributed to a charitable organization.[3] However, in the case of a charitable contribution of inventory or other ordinary-income property, short-term capital gain property, or certain gifts to private foundations, the amount of the deduction is limited to the taxpayer's basis in the property.[4] In the case of a charitable contribution of tangible personal property, a taxpayer's deduction is limited to the adjusted basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose (sec. 170(e)(1)(B)(i)).

For purposes of computing alternative minimum taxable income (AMTI), the deduction for charitable contributions of capital gain property (real, personal, or intangible) is disallowed to the extent that the fair-market value of the property exceeds its adjusted basis (sec. 57(a)(6)). However, in the case of a contribution made in a taxable year beginning in 1991 or made before July 1, 1992, in a taxable year beginning in 1992, this rule does not apply to contributions of tangible personal property.

Reasons for change

The committee believes that the temporary AMT exception for contributions of appreciated tangible personal property has induced additional charitable giving. Thus, by extending this rule through 1993 and expanding it to apply to all appreciated property gifts, taxpayers will be allowed the same charitable contribution deduction for both regular tax and alternative minimum tax purposes for contributions made during 1992 and 1993. This will provide an additional incentive for taxpayers to make contributions of appreciated property.

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[3] The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)).

[4] Section 170(e)(3) provides an augmented deduction for certain corporate contributions of inventory property for the care of the ill, the needy, or infants.

In addition, to reduce uncertainty and disputes arising out of charitable contributions of property, the committee believes that the Treasury Department should develop a procedure under which taxpayers could seek an agreement with the IRS as to the value of tangible personal property prior to the donation of such property to a charity.

Explanation of provisions

Extension of AMT relief for donated appreciated property

All charitable contributions of appreciated property (real, personal, and intangible) made during 1992 and 1993 will not be treated as a tax preference item for alternative minimum tax (AMT) purposes.

Thus, during 1992 and 1993, if a taxpayer makes a gift to charity of property (other than inventory or other ordinary income property, short-term capital gain property, or certain gifts to private foundations) that is real property, intangible property, or tangible personal property the use of which is related to the donee's tax-exempt purpose, the taxpayer is allowed to claim a deduction for both regular tax and AMT purposes in the amount of the property's fair-market value (subject to present-law percentage limitations).[5] Any carryover of an excess contribution deduction from a contribution made during the period January 1, 1992, through December 31, 1993, also will not be treated as a tax preference item for AMT purposes in any succeeding taxable year to which the excess may be carried forward in accordance with the rules of section 170.

Treasury report on advance valuation procedure

Not later than one year after the date of enactment of the bill, the Secretary of the Treasury is required to submit a report to the Senate Committee on Finance and the House Committee on Ways and Means, reporting on the development of a procedure under which taxpayers could elect to seek an agreement with the Secretary as to the value of tangible personal property prior to the donation of such property to a qualifying charitable organization (provided that time limits for donation and any other conditions contained in the agreement are satisfied). The report should address the setting of possible threshold amounts for claimed value (and the payment of fees) by a taxpayer in order to seek agreement under the procedure, possible limitations on applying the procedure only to items with significant artistic or cultural value, and recommendations for legislative action needed to implement the procedure.

Effective date

The provision governing the AMT treatment of gifts of appreciated property is effective for contributions made in 1992 and 1993. The Secretary of the Treasury is required to report to Congress not later than one year after enactment on the development of an ad-

[5] Contributions of inventory or other ordinary income property, short-term capital gain property, and certain gifts to private foundations continue to be governed by present-law rules.

vance valuation procedure for certain charitable contributions of tangible personal property.

11. EXCISE TAX ON CERTAIN VACCINES FOR THE VACCINE INJURY COMPENSATION TRUST FUND (SEC. 111 OF THE BILL AND SECS. 4131 AND 9510 OF THE CODE)

Present law

The Vaccine Injury Compensation Trust Fund ("Vaccine Trust Fund") provides a source of revenue to compensate individuals who are injured (or die) as a result of the administration of certain vaccines: diphtheria, pertussis, and tetanus ("DPT"); diphtheria and tetanus ("DT"); measles, mumps, and rubella ("MMR"); and polio. The Vaccine Trust Fund provides the funding source for the National Vaccine Injury Compensation Program ("Program"), which provides a substitute, Federal "no-fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers.

Under the Program, all persons who were immunized with a covered vaccine after the effective date of the Program, October 1, 1988, are prohibited from commencing a civil action in State court for vaccine-related damages unless they first file a petition with the United States Claims Court, where such petitions are assigned to a special master and governed by streamlined procedural rules designed to expedite the proceedings.[6] In these cases, the Federal Government is the respondent party in the proceedings, and the claimant generally must show only that certain medical conditions (or death) followed the administration of a covered vaccine and that the first onset of symptoms occurred within a prescribed time period.[7] Compensation under the Program generally is limited to actual and projected unreimbursed medical, rehabilitative, and custodial expenses, lost earnings, pain and suffering (or, in the event of death, a recovery for the estate) up to $250,000, and reasonable attorney's fees.[8] Only if the final settlement under the Program is rejected may the claimant proceed with a civil tort action in the appropriate State court, where recovery generally will be governed by State tort law principles,[9] subject to certain limitations and

[6] Persons who received vaccines before the Program's effective date of October 1, 1988 ("retrospective cases") also may be eligible for compensation under the Program if they had not yet received compensation and elected to file a petition with the United States Claims Court on or before January 31, 1991. Under the Program, awards in retrospective cases are somewhat limited compared to "prospective cases" (i.e., those where the vaccine was administered on or after October 1, 1988). Awards in retrospective cases are not paid out of the Vaccine Trust Fund but are paid out of funds specially authorized by Congress. See 42 U.S.C. sec. 300aa-15(i), (j) (appropriating $80 million for fiscal year 1989 and for each subsequent year).

[7] Compensation may not be awarded, however, if there is a preponderance of the evidence that the claimant's condition or death resulted from factors unrelated to the vaccine in question.

[8] 42 U.S.C. sec. 300aa-15.

The committee wishes to clarify its understanding that amounts received by a claimant from the Vaccine Trust Fund constitute damages received on account of personal injuries or sickness for purposes of the exclusion from gross income provided by the general rules of section 104(a)(2).

[9] In most State proceedings, significant issues arise whether injuries suffered by a child after immunization were, in fact, caused by the vaccine administered and whether the manufacturer was at fault in either the manufacture or marketing of the vaccine.

specifications imposed by the National Childhood Vaccine Injury Act of 1986.[10]

The Vaccine Trust Fund is funded by a manufacturer's excise tax on DPT, DT, MMR, and polio vaccines (and any other vaccines used to prevent these diseases). The excise tax per dose is $4.56 for DPT, $0.06 for DT, $4.44 for MMR, and $0.29 for polio vaccines.

The vaccine excise tax will expire after the later of: (1) December 31, 1992; or (2) the date on which the Vaccine Trust Fund revenues exceed the projected liabilities with respect to compensable injuries from vaccines administered before October 1, 1992. Amounts in the Vaccine Trust Fund are available for the payment of compensation under the Program with respect to vaccines administered after September 30, 1988, and before October 1, 1992.

Reasons for change

Congress created the National Vaccine Injury Compensation Program as part of the National Childhood Vaccine Injury Act of 1986, in view of concerns that the combination of significantly higher prices for vaccines and uncertain compensation for injuries could result in reduced compliance with the nation's childhood immunization efforts. The Program became effective following enactment of a Federal funding source. This funding source was provided by the enactment of vaccine excise taxes in the Omnibus Budget Reconciliation Act of 1987, with the excise taxes imposed on sales of covered vaccines on or after January 1, 1988. The Program for administering claims became effective on October 1, 1988, but was not fully operational until February 1, 1989.[11]

Because data on the administration of the Program and the Vaccine Trust Fund are only beginning to be collected, it is appropriate to extend for two years (i.e., through December 31, 1994) the present-law vaccine excise taxes. In addition, the authorization for compensation to be paid from the Vaccine Trust Fund for certain damages resulting from vaccines administered after September 30, 1988, and before October 1, 1992, is extended for two years (i.e., for vaccines administered before October 1, 1994). In the interim, the Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, should study the administration of the Program and Vaccine Trust Fund to determine whether additional vaccines should be included in the Program or other modifications (such as adjustments to the excise tax rates) are warranted.

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[10] Title III, P.L. 99-660. This Act preempts State tort law to a limited extent by imposing limits on recovery from vaccine manufacturers. Among the limitations are a prohibition on compensation if the injury or death resulted from side effects that were unavoidable; a presumption that manufacturers are not negligent in manufacturing or marketing vaccines if they complied, in all material respects, with Federal Food and Drug Administration requirements; and limits on punitive damage awards.

[11] Several procedural aspects of the Program were amended by section 6601 of the Omnibus Budget Reconciliation Act of 1989. To date, most of the dispositions under the Program have involved so-called "retrospective cases." See Mariner, Wendy K., "Innovation and Challenge: The First Year of the National Vaccine Injury Compensation Program," May 1991, report prepared for consideration by the Administrative Conference of the United States.

Explanation of provisions

Extension of excise tax and program funding

The present-law excise taxes imposed on certain vaccines are extended for two years (i.e., through December 31, 1994). Authorization for compensation to be paid from the Vaccine Trust Fund for certain damages resulting from vaccines administered after September 30, 1988, and before October 1, 1992, also is extended for two years (i.e., for vaccines administered after September 30, 1988, and before October 1, 1994).

Study

In addition, the Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, is directed to conduct a study of: (1) the estimated amount that will be paid from the Vaccine Trust Fund with respect to vaccines administered after September 30, 1988, and before October 1, 1994; (2) the rates of vaccine-related injury or death with respect to various types of vaccines; (3) new vaccines and immunization practices being developed or used for which amounts may be paid from the Vaccine Trust Fund; (4) whether additional vaccines should be included in the Program; and (5) the appropriate treatment of vaccines produced by State governmental entities. The Secretary of the Treasury must submit a report detailing his findings not later than January 1, 1994, to the House Committee on Ways and Means and the Senate Committee on Finance.

Effective date

The provisions are effective on the date of enactment.

12. PERMANENT EXTENSION OF GENERAL FUND TRANSFER TO RAILROAD RETIREMENT TIER 2 FUND (SEC. 112 OF THE BILL)

Present law

The proceeds from the income taxation of railroad retirement tier 2 benefits are transferred from the general fund of the Treasury to the Railroad Retirement Account. This transfer applies only to proceeds from the taxation of benefits which have been received prior to October 1, 1992. Proceeds from the taxation of benefits received after this date remain in the general fund.

Reasons for change

It is appropriate to make permanent the transfer of funds from the general fund of the Treasury to the Railroad Retirement Account to promote the ongoing solvency of the Railroad Retirement system.

Explanation of provision

The transfer of proceeds from the income taxation of railroad retirement tier 2 benefits from the general fund of the Treasury to the Railroad Retirement Account is made permanent.

Effective date

The provision is effective beginning September 30, 1992.

13. ALLOCATION AND APPORTIONMENT OF RESEARCH EXPENSES (SECS. 861-864 OF THE CODE)

Present law

U.S. persons are taxable on their worldwide income, including their foreign income. Foreign source taxable income equals foreign source gross income less the expenses, losses and other deductions properly apportioned or allocated to that income. The Internal Revenue Code generally articulates only the broad principles of how expenses reduce U.S. and foreign source gross income, leaving the Treasury Department to provide detailed rules for the task of allocating and apportioning expenses.

Treasury regulations issued in 1977 described methods for allocating expenses between U.S. and foreign source income, including rules for the allocation of research and development (R&D) expenses. Upon issuance of these regulations, a significant dispute regarding the appropriate allocation of R&D expenses developed between taxpayers and the Treasury Department. This unresolved dispute between taxpayers and the Treasury Department precipitated Congressional involvement on this issue, and since 1981, the R&D allocation regulations have been subject to a series of eight suspensions and temporary modifications. The current temporary provision is applicable generally for the first six months of the first taxable year beginning after August 1, 1991, and among other rules, automatically allocates 64 percent of U.S. performed R&D to U.S. source income, and generally permits a greater amount of taxable income to be classified as foreign source than under the 1977 regulations. This will increase the benefits of the foreign tax credit to many taxpayers.

Reasons for change

The committee believes that the Treasury Department should now resolve this controversy. The President's Fiscal Year 1993 Budget contains a proposal to provide an 18-month extension of these R&D allocation rules. The "General Explanations of the President's Budget Proposals Affecting Receipts" (January 1992), in a section entitled "Jobs and Investments," states that the Administration believes in providing tax incentives to increase the performance of U.S.-based research activities. Further, the Treasury explanation states that by enhancing the return on R&D expenditures, the proposal encourages the growth of overall R&D activity as well as the location of such research within the United States.

Explanation of provision

The committee believes that the Treasury Department has broad authority under current law to revise the current R&D allocation regulations. Since the Administration has indicated its support of an allocation system that provides incentives to increase the performance of U.S.-based research activities, the committee expects, and in the strongest terms, urges the Treasury Department to revise its permanent regulations in a manner consistent with the Administration's stated objectives and proposals. The committee believes that such a revision would be consistent both with current law regulatory authority and with the stated goals of the Administration.

The committee further urges the Treasury Department, when revising its regulations, to take into consideration that taxpayers, in appropriate circumstances, are required for business purposes to conduct significant amounts of R&D at foreign sites and should not be penalized by the allocation rules.

Effective date

The committee expects and requests the Treasury Department to issue regulations as soon as possible, to be effective after the termination of the current temporary rules.

TITLE II. LUXURY EXCISE TAX; DIESEL FUEL EXCISE TAX ON MOTORBOATS

1. REPEAL OF LUXURY EXCISE TAX ON BOATS, AIRCRAFT, JEWELRY, AND FURS; INDEXING OF LUXURY EXCISE TAX ON AUTOMOBILES (SEC. 201 OF THE BILL AND SECS. 4001–4012 OF THE CODE)

Present law

Present law imposes a ten-percent excise tax on the portion of the retail price of the following items that exceeds the thresholds specified: automobiles above $30,000; boats above $100,000; aircraft above $250,000; jewelry above $10,000; and furs above $10,000. The tax also applies to subsequent purchases of component parts and accessories, occurring within 6 months of the date the automobile, boat, or aircraft is placed in service.

The tax generally applies only to the first retail sale after manufacture, production or importation of items subject to the tax. It does not apply to subsequent sales of these items. The taxes on automobiles, boats, and aircraft generally do not apply to items used in trade or business.

The tax applies to sales before January 1, 2000.

Reasons for change

During the recent recession, the boat, aircraft, jewelry, and fur industries have suffered job losses and increased unemployment. The committee believes, in the context of the current general economic hardship, that it is appropriate to eliminate the burden these taxes impose in the interests of fostering economic recovery in those and related industries.

The committee recognizes that in the absence of indexation of the threshold above which the tax on automobiles applies, even modest inflation will subject more automobiles to the luxury tax than were subject to the tax when it was first enacted.

The committee further believes that it is unfair and inappropriate to treat as luxury purchases those accessories or modifications which must be purchased by an individual with a disability to enable him or her to operate or to enter or exit a vehicle.

Explanation of provision

Repeal of tax on boats, aircraft, jewelry, and fur

The bill repeals the luxury excise tax imposed on boats, airplanes, jewelry, and furs.

Indexing of tax on automobiles

The bill modifies the luxury excise tax on automobiles to provide that the $30,000 threshold is indexed annually for inflation occurring after 1990. Consequently, the applicable threshold for 1992 will be $30,000 increased by the 1991 inflation rate.

Exemption for certain equipment installed on passenger vehicles for use by disabled individuals

The bill provides that the luxury excise tax does not apply to a part or accessory installed on a passenger vehicle to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle, in order to compensate for the effect of the disability. This exception does not apply to accessories commonly available from the manufacturer or dealer, such as power steering, power door locks, power seats, or power windows.

Effective date

The repeal of the luxury excise taxes on boats, aircraft, jewelry, and furs is effective for sales on or after January 1, 1992. The indexation of the threshold applicable to automobiles is effective for sales on or after July 1, 1992. The provision relating to the purchase of accessories or modifications by disabled persons is effective for purchases after December 31, 1990.

Persons entitled to a refund may request it from the seller at which they purchased the taxed item, who then obtains the refund as provided under present-law Code section 6416.

2. IMPOSE EXCISE TAX ON DIESEL FUEL USED IN NONCOMMERCIAL MOTORBOATS (SEC. 202 OF THE BILL AND SECS. 4092, 4041, 6421, 9503, AND 9508 OF THE CODE)

Present law

Federal excise taxes generally are imposed on gasoline and special motor fuels used in highway transportation and by certain off highway recreational trail vehicles and by boats (14 cents per gallon). A Federal excise tax also is imposed on diesel fuel (20 cents per gallon) used in highway transportation. Diesel fuel used in trains generally is taxed at 2.5 cents per gallon.

The revenues from these taxes, minus 2.5 cents per gallon, are deposited in the Highway Trust Fund, the National Recreational Trails Trust Fund, or the Aquatic Resources Trust Fund through September 30, 1999. Revenues from the remaining 2.5 cents per gallon are retained in the General Fund through September 30, 1995, after which time the 2.5-cents-per-gallon portion of the taxes (including the tax on diesel fuel used in trains) is scheduled to expire.

An additional 0.1-cent-per-gallon tax applies to these fuels to finance the Leaking Underground Storage Trust Fund, generally through December 31, 1995.

Diesel fuel used in boats is not taxed.

Reasons for change

The bill eliminates the discrepancy between gasoline used by pleasure boats (which is taxable) and diesel fuel used by these boats (which is not taxable).

Explanation of provision

The bill extends the current 20.1-cents-per-gallon diesel fuel excise taxes to diesel fuel used by boats. Fuel used by boats for commercial fishing, transportation for compensation or hire, or for business use other than predominantly for entertainment, amusement, or recreation, remains exempt.

The tax is collected at the same point in the distribution chain as the highway diesel fuel tax (i.e., on sale to a retailer). However, to prevent unnecessary tax-paid sales followed by refunds, retailers that sell diesel fuel exclusively to commercial (i.e., nonpleasure) boats are permitted to buy the fuel tax-free.

The revenues from the 20.1-cents-per-gallon tax on diesel fuel used by boats will be retained in the General Fund.

Effective date

The provision is effective after September 30, 1992.

TITLE III. OTHER REVENUE-RAISING PROVISIONS

1. MODIFY ESTIMATED TAX PAYMENT RULES FOR LARGE CORPORATIONS (SEC. 301 OF THE BILL AND SEC. 6655 OF THE CODE)

Present law

A corporation is subject to an addition to tax for any underpayment of estimated tax. For taxable years beginning in 1993, 1994, 1995, and 1996, a corporation does not have an underpayment of estimated tax if it makes four equal timely estimated tax payments that total at least 95 percent of the tax liability shown on the return for the current taxable year. In addition, a corporation may annualize its taxable income and make estimated tax payments based on 95 percent of the tax liability attributable to such annualized income.

For taxable years beginning in 1992, the 95-percent requirement is a 93-percent requirement; the 95-percent requirement becomes a 90-percent requirement for taxable years beginning in 1997 and thereafter (P.L. 102–44, Feb. 7, 1992).

On June 11, 1992, the Senate Finance Committee voted to provide that for taxable years beginning after June 30, 1992, and before 1997, the present-law 93-percent and 95-percent requirements would become 96-percent requirements (the "Unemployment Compensation Amendments of 1992" (H.R. 5260)). Also under the provision, for taxable years beginning after 1996, the present-law 90-percent requirement would become a 91-percent requirement.

A corporation that is not a "large corporation" generally may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25 percent of the tax liability shown on its return for the preceding taxable year (the "100 percent of last year's liability safe harbor"). A large corporation may use this rule with respect to its estimated tax payment for the first quarter of its current taxable year. A large corporation is one that had taxable income of $1 million or more for any of the three preceding taxable years.

Reasons for change

The committee believes that it is appropriate to require a large corporation to base its estimated tax payments on amounts that more closely approximate its ultimate tax liability for the year.

Explanation of provision

For taxable years beginning after 1996, the percentage of current-year tax liability upon which a large corporation is required to base its estimated tax payments is increased by five percentage points, whether such liability is determined on an actual or annualized basis.

The bill does not change the present-law availability of the 100 percent of last year's liability safe harbor for large or small corporations.

Effective date

The provision is effective for estimated tax payments applicable to taxable years beginning after December 31, 1996.

2. AMORTIZATION OF GOODWILL AND CERTAIN OTHER INTANGIBLES (SEC. 302 OF THE BILL AND SECS. 167, 1060, 1253, AND NEW SEC. 197 OF THE CODE)

Present law

In determining taxable income for Federal income tax purposes, a taxpayer is allowed depreciation or amortization deductions for the cost or other basis of intangible property that is used in a trade or business or held for the production of income if the property has a limited useful life that may be determined with reasonable accuracy. No depreciation or amortization deductions are allowed with respect to goodwill or going concern value.

Reasons for change

The Federal income tax treatment of the costs of acquiring intangible assets is a source of considerable controversy between taxpayers and the Internal Revenue Service. Disputes arise concerning: (1) whether an amortizable intangible asset exists; (2) in the case of an acquisition of a trade or business, the portion of the purchase price that is allocable to an amortizable intangible asset; and (3) the proper method and period for recovering the cost of an amortizable intangible asset.

It is believed that much of the controversy that arises under present law with respect to acquired intangible assets could be eliminated by specifying a single method and period for recovering the cost of most acquired intangible assets and by treating acquired goodwill and going concern value as amortizable intangible assets. It is also believed that there is no need at this time to change the Federal income tax treatment of self-created intangible assets, such as goodwill that is created through advertising and other similar expenditures.

Accordingly, the bill requires the cost of most acquired intangible assets, including goodwill and going concern value, to be amortized ratably over a 16-year period. It is recognized that the useful lives of certain acquired intangible assets to which the bill applies may be shorter than 16 years, while the useful lives of other acquired intangible assets to which the bill applies may be longer than 16 years. The 16-year amortization period was selected so that, prospectively applied, the bill would be approximately revenue neutral over the next five fiscal years.

In addition, it is desirable to facilitate the settlement of controversies that have arisen or may arise with respect to intangibles assets that were acquired in past open years by providing an election to clarify the treatment of such property.

Explanation of provision

In general

The bill allows an amortization deduction with respect to the capitalized costs of certain intangible property (defined as a "section 197 intangible") that is acquired by a taxpayer and that is held by the taxpayer in connection with the conduct of a trade or business or an activity engaged in for the production of income. The amount of the deduction is determined by amortizing the adjusted basis (for purposes of determining gain) of the intangible ratably over a 16-year period that begins with the month that the intangible is acquired.[12] No other depreciation or amortization deduction is allowed with respect to a section 197 intangible that is acquired by a taxpayer.

In general, the bill applies to a section 197 intangible acquired by a taxpayer regardless of whether it is acquired as part of a trade or business. In addition, the bill generally applies to a section 197 intangible that is treated as acquired under section 338 of the Code. The bill generally does not apply to a section 197 intangible that is created by the taxpayer if the intangible is not created in connection with a transaction (or series of related transactions) that involves the acquisition of a trade or business or a substantial portion thereof.

Except in the case of amounts paid or incurred under certain covenants not to compete (or under certain other arrangements that have substantially the same effect as covenants not to compete) and certain amounts paid or incurred on account of the transfer of a franchise, trademark, or trade name, the bill generally does not apply to any amount that is otherwise currently deductible (i.e., not capitalized) under present law.

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[12] In the case of a short taxable year, the amortization deduction is to be based on the number of months in such taxable year.

No inference is intended as to whether a depreciation or amortization deduction is allowed under present law with respect to any intangible property that is either included in, or excluded from, the definition of a section 197 intangible. In addition, no inference is intended as to whether an asset is to be considered tangible or intangible property for any other purpose of the Internal Revenue Code.

Definition of section 197 intangible

In general

The term "section 197 intangible" is defined as any property that is included in any one or more of the following categories: (1) goodwill and going concern value; (2) certain specified types of intangible property that generally relate to workforce, information base, know-how, customers, suppliers, or other similar items; (3) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof; (4) any covenant not to compete (or other arrangement to the extent that the arrangement has substantially the same effect as a covenant not to compete) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (5) any franchise, trademark, or trade name.

Certain types of property, however, are specifically excluded from the definition of the term "section 197 intangible." The term "section 197 intangible" does not include: (1) any interest in a corporation, partnership, trust, or estate; (2) any interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract; (3) any interest in land; (4) certain computer software; (5) certain interests in films, sound recordings, video tapes, books, or other similar property; (6) certain rights to receive tangible property or services; (7) certain interests in patents or copyrights; (8) any interest under an existing lease of tangible property; (9) any interest under an existing indebtedness (except for the deposit base and similar items of a financial institution); (10) a franchise to engage in any professional sport, and any item acquired in connection with such a franchise; (11) certain purchased mortgage servicing rights; and (12) if the taxpayer elects, intangibles acquired from a "qualified research entity".

In addition, the Treasury Department is authorized to issue regulations that exclude certain rights of fixed duration or amount from the definition of a section 197 intangible.

Goodwill and going concern value

For purposes of the bill, goodwill is the value of a trade or business that is attributable to the expectancy of continued customer patronage, whether due to the name of a trade or business, the reputation of a trade or business, or any other factor.

In addition, for purposes of the bill, going concern value is the additional element of value of a trade or business that attaches to property by reason of its existence as an integral part of a going concern. Going concern value includes the value that is attributable to the ability of a trade or business to continue to function and generate income without interruption notwithstanding a change in ownership. Going concern value also includes the value that is attributable to the use or availability of an acquired trade or business (for example, the net earnings that otherwise would not be received during any period were the acquired trade or business not available or operational).

Workforce, information base, know-how, customer-based intangibles, supplier-based intangibles and other similar items

Workforce.—The term "section 197 intangible" includes workforce in place (which is sometimes referred to as agency force or assembled workforce), the composition of a workforce (for example, the experience, education, or training of a workforce), the terms and conditions of employment whether contractual or otherwise, and any other value placed on employees or any of their attributes. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of a highly-skilled workforce is to be amortized over the 16-year period specified in the bill. As a further example, the cost of acquiring an existing employment contract (or contracts) or a relationship with employees or consultants (including but not limited to any "key employee" contract or relationship) as part of the acquisition of a trade or business is to be amortized over the 16-year period specified in the bill.

Information base.—The term "section 197 intangible" includes business books and records, operating systems, and any other information base including lists or other information with respect to current or prospective customers (regardless of the method of recording such information). Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the intangible value of technical manuals, training manuals or programs, data files, and accounting or inventory control systems is to be amortized over the 16-year period specified in the bill. As a further example, the cost of acquiring customer lists, subscription lists, insurance expirations,[13] patient or client files, or lists of newspaper, magazine, radio or television advertisers is to be amortized over the 16-year period specified in the bill.

Know-how.—The term "section 197 intangible" includes any patent, copyright, formula, process, design, pattern, know-how, format, or other similar item. For this purpose, the term "section 197 intangible" is to include package designs, computer software, and any interest in a film, sound recording, video tape, book, or other similar property, except as specifically provided otherwise in the bill.[14]

Customer-based intangibles.—The term "section 197 intangible" includes any customer-based intangible, which is defined as the composition of market, market share, and any other value resulting from the future provision of goods or services pursuant to relationships with customers (contractual or otherwise) in the ordinary

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[13] Insurance expirations are records that are maintained by insurance agents with respect to insurance customers. These records generally include information relating to the type of insurance, the amount of insurance, and the expiration date of the insurance.

[14] See below for a description of the exceptions for certain patents, certain computer software, and certain interests in films, sound recordings, video tapes, books, or other similar property.

course of business. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of customer base, circulation base, undeveloped market or market growth, insurance in force, mortgage servicing contracts,[15] investment management contracts, or other relationships with customers that involve the future provision of goods or services, is to be amortized over the 16-year period specified in the bill. On the other hand, the portion (if any) of the purchase price of an acquired trade or business that is attributable to accounts receivable or other similar rights to income for those goods or services that have been provided to customers prior to the acquisition of a trade or business is not to be taken into account under the bill.[16]

In addition, the bill specifically provides that the term "customer-based intangible" includes the deposit base and any similar asset of a financial institution. Thus, for example, the portion (if any) of the purchase price of an acquired financial institution that is attributable to the checking accounts, savings accounts, escrow accounts and other similar items of the financial institution is to be amortized over the 16-year period specified in the bill.

Supplier-based intangibles.—The term "section 197 intangible" includes any supplier-based intangible, which is defined as the value resulting from the future acquisition of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of a favorable relationship with persons that provide distribution services (for example, favorable shelf or display space at a retail outlet), the existence of a favorable credit rating, or the existence of favorable supply contracts, is to be amortized over the 16-year period specified in the bill.[17]

Other similar items.—The term "section 197 intangible" also includes any other intangible property that is similar to workforce, information base, know-how, customer-based intangibles, or supplier-based intangibles.

Licenses, permits, and other rights granted by governmental units

The term "section 197 intangible" also includes any license, permit, or other right granted by a governmental unit or any agency or instrumentality thereof (even if the right is granted for an indefinite period or the right is reasonably expected to be renewed for an indefinite period).[18] Thus, for example, the capital-

[15] Certain purchased mortgage servicing rights are excluded from the definition of a section 197 intangible under special rules described below.

[16] As under present law, the portion of the purchase price of an acquired trade or business that is attributable to accounts receivable is to be allocated among such receivables and is to be taken into account as payment is received under each receivable or at the time that a receivable becomes worthless.

[17] See below, however, for a description of the exception for certain rights to receive tangible property or services from another person.

[18] A right granted by a governmental unit or an agency or instrumentality thereof that constitutes an interest in land or an interest under a lease of tangible property is excluded from the definition of a section 197 intangible. See below for a description of the exceptions for interests in land and for interests under leases of tangible property.

ized cost of acquiring from any person a liquor license, a taxi-cab medallion (or license), an airport landing or takeoff right (which is sometimes referred to as a slot), a regulated airline route, or a television or radio broadcasting license is to be amortized over the 16-year period specified in the bill. For purposes of the bill, the issuance or renewal of a license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof is to be considered an acquisition of such license, permit, or other right.

Covenants not to compete and other similar arrangements

The term "section 197 intangible" also includes any covenant not to compete (or other arrangement to the extent that the arrangement has substantially the same effect as a covenant not to compete; hereafter "other similar arrangement") entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof). For this purpose, an interest in a trade or business includes not only the assets of a trade or business, but also stock in a corporation that is engaged in a trade or business or an interest in a partnership that is engaged in a trade or business.

Any amount that is paid or incurred under a covenant not to compete (or other similar arrangement) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof) is chargeable to capital account and is to be amortized ratably over the 16-year period specified in the bill. In addition, any amount that is paid or incurred under a covenant not to compete (or other similar arrangement) after the taxable year in which the covenant (or other similar arrangement) was entered into is to be amortized ratably over the remaining months in the 16-year amortization period that applies to the covenant (or other similar arrangement) as of the beginning of the month that the amount is paid or incurred.

For purposes of this provision, an arrangement that requires the former owner of an interest in a trade or business to continue to perform services (or to provide property or the use of property) that benefit the trade or business is considered to have substantially the same effect as a covenant not to compete to the extent that the amount paid to the former owner under the arrangement exceeds the amount that represents reasonable compensation for the services actually rendered (or for the property or use of property actually provided) by the former owner. As under present law, to the extent that the amount paid or incurred under a covenant not to compete (or other similar arrangement) represents additional consideration for the acquisition of stock in a corporation, such amount is not to be taken into account under this provision but, instead, is to be included as part of the acquirer's basis in the stock.

Franchises, trademarks, and trade names

The term "section 197 intangible" also includes any franchise, trademark, or trade name. For this purpose, the term "franchise" is defined, as under present law, to include any agreement that provides one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area.[19] In addition, as provided under present law, the renewal of a franchise, trademark, or trade name is to be treated as an acquisition of such franchise, trademark, or trade name.[20]

The bill continues the present-law treatment of certain contingent amounts that are paid or incurred on account of the transfer of a franchise, trademark, or trade name. Under these rules, a deduction is allowed for amounts that are contingent on the productivity, use, or disposition of a franchise, trademark, or trade name only if (1) the contingent amounts are paid as part of a series of payments that are payable at least annually throughout the term of the transfer agreement, and (2) the payments are substantially equal in amount or payable under a fixed formula.[21] Any other amount, whether fixed or contingent, that is paid or incurred on account of the transfer of a franchise, trademark, or trade name is chargeable to capital account and is to be amortized ratably over the 16-year period specified in the bill.

Exceptions to the definition of a section 197 intangible

In general.—The bill contains several exceptions to the definition of the term "section 197 intangible." Several of the exceptions contained in the bill apply only if the intangible property is not acquired in a transaction (or series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business. It is anticipated that the Treasury Department will exercise its regulatory authority to require any intangible property that would otherwise be excluded from the definition of the term "section 197 intangible" to be taken into account under the bill under circumstances where the acquisition of the intangible property is, in and of itself, the acquisition of an asset which constitutes a trade or business or a substantial portion of a trade or business.

The determination of whether acquired assets constitute a substantial portion of a trade or business is to be based on all of the facts and circumstances, including the nature and the amount of the assets acquired as well as the nature and amount of the assets retained by the transferor. It is not intended, however, that the value of the assets acquired relative to the value of the assets retained by the transferor is determinative of whether the acquired assets constitute a substantial portion of a trade or business.

For purposes of the bill, a group of assets is to constitute a trade or business if the use of such assets would constitute a trade or business for purposes of section 1060 of the Code (i.e., if the assets are of such a character that goodwill or going concern value could under any circumstances attach to the assets). In addition, the acquisition of a franchise, trademark or trade name is to constitute the acquisition of a trade or business or a substantial portion of a trade or business.

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[19] Section 1253(b)(1) of the Code.

[20] Only the costs incurred in connection with the renewal, however, are to be amortized over the 16-year period that begins with the month that the franchise, trademark, or trade name is renewed. Any costs incurred in connection with the issuance (or an earlier renewal) of a franchise, trademark, or trade name are to continue to be taken into account over the remaining portion of the amortization period that began at the time of such issuance (or earlier renewal).

[21] Section 1253(d)(1) of the Code.

In determining whether a taxpayer has acquired an intangible asset in a transaction (or series of related transactions) that involves the acquisition of assets that constitute a trade or business or a substantial portion of a trade or business, only those assets acquired in a transaction (or a series of related transactions) by a taxpayer (and persons related to the taxpayer) from the same person (and any related person) are to be taken into account. In addition, any employee relationships that continue (or covenants not to compete that are entered into) as part of the transfer of assets are to be taken into account in determining whether the transferred assets constitute a trade or business or a substantial portion of a trade or business.

Interests in a corporation, partnership, trust, or estate.—The term "section 197 intangible" does not include any interest in a corporation, partnership, trust, or estate. Thus, for example, the bill does not apply to the cost of acquiring stock, partnership interests, or interests in a trust or estate, whether or not such interests are regularly traded on an established market.[22]

Interests under certain financial contracts.—The term "section 197 intangible" does not include any interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract, whether or not such interest is regularly traded on an established market. Any interest under a mortgage servicing contract,[23] credit card servicing contract or other contract to service indebtedness issued by another person, and any interest under an assumption reinsurance contract [24] is not excluded from the definition of the term "section 197 intangible" by reason of the exception for interests under certain financial contracts.

Interests in land.—The term "section 197 intangible" does not include any interest in land. Thus, the cost of acquiring an interest in land is to be taken into account under present law rather than under the bill. For this purpose, an interest in land includes a fee interest, life estate, remainder, easement, mineral rights, timber rights, grazing rights, riparian rights, air rights, zoning variances, and any other similar rights with respect to land. An interest in land is not to include an airport landing or takeoff right, a regulated airline route, or a franchise to provide cable television services.

Certain computer software.—The term "section 197 intangible" does not include computer software (whether acquired as part of a trade or business or otherwise) that (1) is readily available for purchase by the general public; (2) is subject to a non-exclusive license; and (3) has not been substantially modified. In addition, the term "section 197 intangible" does not include computer software which is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

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[22] A temporal interest in property, outright or in trust, may not be used to convert a section 197 intangible into property that is amortizable more rapidly than ratably over the 16-year period specified in the bill.

[23] Certain purchased mortgage servicing rights are excluded from the definition of a section 197 intangible under special rules described below.

[24] See below for a description of the treatment of assumption reinsurance contracts.

For purposes of the bill, the term "computer software" is defined as any program (i.e., any sequence of machine-readable code) that is designed to cause a computer to perform a desired function. The term "computer software" includes any incidental and ancillary rights with respect to computer software that (1) are necessary to effect the legal acquisition of the title to, and the ownership of, the computer software, and (2) are used only in connection with the computer software. The term "computer software" does not include any data base or similar item (other than a data base or item that is in the public domain and that is incidental to the software) [25] regardless of the form in which it is maintained or stored.

If a depreciation deduction is allowed with respect to any computer software that is not a section 197 intangible solely by reason of the exceptions described in the preceding paragraph,[26] the amount of the deduction is to be determined by amortizing the adjusted basis of the computer software ratably over a 36-month period that begins with the month that the computer software is placed in service. For this purpose, the cost of any computer software that is taken into account as part of the cost of computer hardware or other tangible property under present law is to continue to be taken into account is such manner under the bill. In addition, the cost of any computer software that is currently deductible (i.e., not capitalized) under present law is to continue to be taken into account in such manner under the bill.

Certain interests in films, sound recordings, video tapes, books, or other similar property.—The term "section 197 intangible" does not include any interest (including an interest as a licensee) in a film, sound recording, video tape, book, or other similar property (including the right to broadcast or transmit a live event) if the interest is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

Certain rights to receive tangible property or services.—The term "section 197 intangible" does not include any right to receive tangible property or services under a contract (or any right to receive tangible property or services granted by a governmental unit or an agency or instrumentality thereof) if the right is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

If a depreciation deduction is allowed with respect to a right to receive tangible property or services that is not a section 197 intangible, the amount of the deduction is to be determined in accordance with regulations to be promulgated by the Treasury Department. It is anticipated that the regulations may provide that in the case of an amortizable right to receive tangible property or services in substantially equal amounts over a fixed period that is not renewable, the cost of acquiring the right will be taken into account

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[25] For example, a data base would not include a dictionary feature used to spell-check a word processing program.

[26] Computer software acquired from a qualified research entity, as described below may also be excluded from the definition of a section 197 intangible. The cost of any intangible assets acquired in such an acquisition, including any computer software, is to be taken into account under present law.

ratably over such fixed period. It is also anticipated that the regulations may provide that in the case of a right to receive a fixed amount of tangible property or services over an unspecified period, the cost of acquiring such right will be taken into account under a method that allows a deduction based on the amount of tangible property or services received during a taxable year compared to the total amount of tangible property or services to be received.

For example, assume that a taxpayer acquires from another person a favorable contract right of such person to receive a specified amount of raw materials each month for the next three years (which is the remaining life of the contract) and that the right to receive such raw materials is not acquired as part of the acquisition of assets that constitute a trade or business or a substantial portion thereof (i.e., such contract right is not a section 197 intangible). It is anticipated that the taxpayer may be required to amortize the cost of acquiring the contract right ratably over the three-year remaining life of the contract. Alternatively, if the favorable contract right is to receive a specified amount of raw materials during an unspecified period, it is anticipated that the taxpayer may be required to amortize the cost of acquiring the contract right by multiplying such cost by a fraction, the numerator of which is the amount of raw materials received under the contract during any taxable year and the denominator of which is the total amount of raw materials to be received under the contract.

It is also anticipated that the regulations may require a taxpayer under appropriate circumstances to amortize the cost of acquiring a renewable right to receive tangible property or services over a period that includes all renewal options exercisable by the taxpayer at less than fair market value.

Certain interests in patents or copyrights.—The term "section 197 intangible" does not include any interest in a patent or copyright which is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

If a depreciation deduction is allowed with respect to an interest in a patent or copyright and the interest is not a section 197 intangible, then the amount of the deduction is to be determined in accordance with regulations to be promulgated by the Treasury Department. It is expected that the regulations may provide that if the purchase price of a patent is payable on an annual basis as a fixed percentage of the revenue derived from the use of the patent, then the amount of the depreciation deduction allowed for any taxable year with respect to the patent equals the amount of the royalty paid or incurred during such year.[27]

Interests under leases of tangible property.—The term "section 197 intangible" does not include any interest as a lessor or lessee under an existing lease of tangible property (whether real or personal).[28] The cost of acquiring an interest as a lessor under a lease

[27] See "Associated Patentees, Inc.", 4 T.C. 979 (1945); and Rev. Rul. 67-136, 1967-1 C.B. 58.

[28] The bill provides that a sublease is to be treated in the same manner as a lease of the underlying property. Thus, the term "section 197 intangible" does not include any interest as a sublessor or sublessee of tangible property.

of tangible property where the interest as lessor is acquired in connection with the acquisition of the tangible property is to be taken into account as part of the cost of the tangible property. For example, if a taxpayer acquires a shopping center that is leased to tenants operating retail stores, the portion (if any) of the purchase price of the shopping center that is attributable to the favorable attributes of the leases is to be taken into account as a part of the basis of the shopping center and is to be taken into account in determining the depreciation deduction allowed with respect to the shopping center.

The cost of acquiring an interest as a lessee under an existing lease of tangible property is to be taken into account under present law (see section 178 of the Code and Treas. Reg. sec. 1.162-11(a)) rather than under the provisions of the bill.[29] In the case of any interest as a lessee under a lease of tangible property that is acquired with any other intangible property (either in the same transaction or series of related transactions), however, the portion of the total purchase price that is allocable to the interest as a lessee is not to exceed the excess of (1) the present value of the fair market value rent for the use of the tangible property for the term of the lease,[30] over (2) the present value of the rent reasonably expected to be paid for the use of the tangible property for the term of the lease.

Interests under indebtedness.—The term "section 197 intangible" does not include any interest (whether as a creditor or debtor) under any indebtedness that was in existence on the date that the interest was acquired.[31] Thus, for example, the value of assuming an existing indebtedness with a below-market interest rate is to be taken into account under present law rather than under the bill. In addition, the premium paid for acquiring the right to receive an above-market rate of interest under a debt instrument may be taken into account under section 171 of the Code, which generally allows the amount of the premium to be amortized on a yield-to-maturity basis over the remaining term of the debt instrument. This exception for interests under existing indebtedness does not apply to the deposit base and other similar items of a financial institution.

Professional sports franchises.—The term "section 197 intangible" does not include a franchise to engage in professional baseball, basketball, football, or other professional sport, and any item acquired in connection with such a franchise. Consequently, the cost of acquiring a professional sports franchise and related assets (including any goodwill, going concern value, or other section 197 intangibles) is to be allocated among the assets acquired as provided

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[29] The lease of a gate at an airport for the purpose of loading and unloading passengers and cargo is a lease of tangible property for this purpose. It is anticipated that such treatment will serve as guidance to the Internal Revenue Service and taxpayers in resolving existing disputes.

[30] In no event is the present value of the fair market value rent for the use of the tangible property for the term of the lease to exceed the fair market value of the tangible property as of the date of acquisition. The present value of such rent is presumed to be less than the value of the tangible property if the duration of the lease is less than the economic useful life of the property.

[31] For purposes of this exception, the term "interest under any existing indebtedness" is to include mortgage servicing rights to the extent that the rights are stripped coupons under section 1286 of the Code. See Rev. Rul. 91-46, 1991-34 I.R.B. 5 (August 26, 1991).

under present law (see, for example, section 1056 of the Code) and is to be taken into account under the provisions of present law.

Purchased mortgage servicing rights.—The term "section 197 intangible" does not include any right to service indebtedness that is secured by residential real property (a "purchased mortgage servicing right"), unless such right is acquired in a transaction (or series of related transactions) involving the acquisition of assets (other than such right or other such purchased mortgage servicing rights) constituting a trade or business or a substantial portion of a trade or business.

Certain property acquired from a qualified research entity.—At the election of the taxpayer, the term "section 197 intangible" does not include any intangible property that is acquired in a qualifying acquisition from a qualified research entity.

A qualified research entity must satisfy certain requirements intended to limit qualification to certain research-intensive start-up entities. First, the excess of the fair market value of the gross assets of the entity over the adjusted issue price of short term debt (debt that has a maturity of one year or less at the time of issuance) must not exceed $50 million.

Second, the entity must not have had any gross receipts (other than earnings on short-term investments of reasonable working capital) during any period more than five years prior to the acquisition. Furthermore, during the entity's entire period of existence on or before the acquisition date, the aggregate amount of expenditures for research and experimentation (within the meaning of section 174 of the Code) which are technological in nature [32] is at least $500,000 and is also at least 30 percent of its aggregate gross receipts (other than earnings on short term investments of reasonable working capital).

Third, at all times during the existence of the entity on or before the acquisition date, at least 50 percent of the fair market value of its equity must be held directly by five or fewer non-corporate persons and at least 50 percent of the fair market value of its equity must be owned by individuals on a look-through basis (other than ownership attributed through a corporation).

The bill provides special attribution rules, aggregation rules, and rules relating to predecessors, as well as rules for applying each of the requirements in the case of a sole proprietorship.

An acquisition from a qualified research entity qualifies for the elective treatment only if substantially all of the section 197 intangibles acquired in the transaction (or a series of related transactions) were created by the qualified research entity or were acquired by that entity in a transaction (or a series of series of related transactions) that themselves would have qualified for the election (apart from the effective date). Thus, for example, a qualified research entity may not act directly or indirectly as a conduit to transfer property from an entity that is not a qualified research entity.

[32] For this purpose it is intended that software development costs qualify as expenditures for research and experimentation under the same standards as applied to the costs of developing other products and processes. I.R.S. Notice 87-12, 1987-1 C.B. 432. *See* Prop. Regs. 1.174-2(a)(6).

Regulatory authority regarding rights of fixed term or duration.—The bill authorizes the Treasury Department to issue regulations that exclude a right received under a contract, or granted by a governmental unit or an agency or instrumentality thereof, from the definition of a section 197 intangible if (1) the right is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business (or a substantial portion thereof) and (2) the right either (A) has a fixed duration of less than 16 years or (B) is fixed as to amount [33] and properly amortizable (without regard to this provision) under a method similar to the unit of production method. Generally, it is anticipated that the mere fact that a taxpayer will have the opportunity to renew a contract or other right on the same terms as are available to others, in a competitive auction or similar process that is designed to reflect fair market value and in which the taxpayer is not contractually advantaged, will not be taken into account in determining the duration of such right or whether it is for a fixed amount.

For example, Company A enters into a license with Company B to use certain know-how developed by B. The license is for five years and provides that it cannot be renewed by A except on terms that are fully available to A's competitors and will reflect an arm's length price determined at the time of renewal. The license does not constitute a substantial portion of a trade or business and is not entered into as part of a transaction (or series of related transactions) that constitute the acquisitions of a trade or business or substantial portion thereof. It is anticipated that in these circumstances the regulations will provide that the license is not a section 197 intangible because it is of fixed duration of less than 16 years.

The regulations may also prescribe rules governing the extent to which renewal options and similar items will be taken into account for the purpose of determining whether rights are fixed in duration or amount.

It is also anticipated that such regulations may prescribe the appropriate method of amortizing the capitalized costs of rights which are excluded by such regulations from the definition of a section 197 intangible.

Exception for certain self-created intangibles

The bill generally does not apply to any section 197 intangible that is created by the taxpayer if the section 197 intangible is not created in connection with a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion thereof.

For purposes of this exception, a section 197 intangible that is owned by a taxpayer is to be considered created by the taxpayer if the intangible is produced for the taxpayer by another person under a contract with the taxpayer that is entered into prior to the production of the intangible. For example, a technological process or other know-how that is developed specifically for a taxpayer

[33] For example, an emission allowance granted a public utility under Title IV of the Clean Air Act Amendments of 1990 is a right that is limited in amount within the meaning of this provision.

under an arrangement with another person pursuant to which the taxpayer retains all rights to the process or know-how is to be considered created by the taxpayer.

The exception for "self-created" intangibles does not apply to the entering into (or renewal of) a contract for the use of a section 197 intangible. Thus, for example, the exception does not apply to the capitalized costs incurred by a licensee in connection with the entering into (or renewal of) a contract for the use of know-how or other section 197 intangible. These capitalized costs are to be amortized over the 16-year period specified in the bill.

In addition, the exception for "self-created" intangibles does not apply to: (1) any license, permit, or other right that is granted by a governmental unit or an agency or instrumentality thereof; (2) any covenant not to compete (or other similar arrangement) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (3) any franchise, trademark, or trade name. Thus, for example, the capitalized costs incurred in connection with the development or registration of a trademark or trade name are to be amortized over the 16-year period specified in the bill.

Special rules

Determination of adjusted basis

The adjusted basis of a section 197 intangible that is acquired from another person generally is to be determined under the principles of present law that apply to tangible property that is acquired from another person. Thus, for example, if a portion of the cost of acquiring an amortizable section 197 intangible is contingent, the adjusted basis of the section 197 intangible is to be increased as of the beginning of the month that the contingent amount is paid or incurred. This additional amount is to be amortized ratably over the remaining months in the 16-year amortization period that applies to the intangible as of the beginning of the month that the contingent amount is paid or incurred.

Treatment of certain dispositions of amortizable section 197 intangibles

Special rules apply if a taxpayer disposes of a section 197 intangible that was acquired in a transaction or series of related transactions and, after the disposition,[34] the taxpayer retains other section 197 intangibles that were acquired in such transaction or series or related transactions.[35] First, no loss is to be recognized by

[34] For this purpose, the abandonment of a section 197 intangible or any other event that renders a section 197 intangible worthless is to be considered a disposition of a section 197 intangible.

[35] These special rules do not apply to a section 197 intangible that is separately acquired (i.e., a section 197 intangible that is acquired other than in a transaction or a series of related transactions that involve the acquisition of other section 197 intangibles). Consequently, a loss may be recognized upon the disposition of a separately acquired section 197 intangible. In no event, however, is the termination or worthlessness of a portion of a section 197 intangible to be considered the disposition of a separately acquired section 197 intangible. For example, the termination of one or more customers from an acquired customer list or the worthlessness of some information from an acquired data base is not to be considered the disposition of a separately acquired section 197 intangible.

reason of such a disposition. Second, the adjusted bases of the retained section 197 intangibles that were acquired in connection with such transaction or series of related transactions are to be increased by the amount of any loss that is not recognized. The adjusted basis of any such retained section 197 intangible is increased by the product of (1) the amount of the loss that is not recognized solely by reason of this provision, and (2) a fraction, the numerator of which is the adjusted basis of the intangible as of the date of the disposition and the denominator of which is the total adjusted bases of all such retained section 197 intangibles as of the date of the disposition.

For purposes of these rules, all persons treated as a single taxpayer under section 41(f)(1) of the Code are treated as a single taxpayer. Thus, for example, a loss is not to be recognized by a corporation upon the disposition of a section 197 intangible if after the disposition a member of the same controlled group as the corporation retains other section 197 intangibles that were acquired in the same transaction (or a series of related transactions) as the section 197 intangible that was disposed of. It is anticipated that the Treasury Department will provide rules for taking into account the amount of any loss that is not recognized due to this rule (for example, by allowing the corporation that disposed of the section 197 intangible to amortize the loss over the remaining portion of the 16-year amortization period).

Treatment of certain nonrecognition transactions

If any section 197 intangible is acquired in a transaction to which section 332, 351, 361, 721, 731, 1031, or 1033 of the Code applies (or any transaction between members of the same affiliated group during any taxable year for which a consolidated return is filed),[36] the transferee is to be treated as the transferor for purposes of applying this provision with respect to the amount of the adjusted basis of the transferee that does not exceed the adjusted basis of the transferor.

For example, assume that an individual owns an amortizable section 197 intangible that has been amortized under section 197 for 4 full years and has a remaining unamortized basis of $300,000. In addition, assume that the individual exchanges the asset and $100,000 for a like-kind amortizable section 197 intangible in a transaction to which section 1031 applies. Under the bill, $300,000 of the basis of the acquired amortizable section 197 intangible is to be amortized over the 12 years remaining in the original 16-year amortization period for the transferred asset and the other $100,000 of basis is to be amortized over the 16-year period specified in the bill.[37]

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[36] The termination of a partnership under section 708(b)(1)(B) of the Code is a transaction to which this rule applies. In such a case, the bill applies only to the extent that the adjusted basis of the section 197 intangibles before the termination exceeds the adjusted basis of the section 197 intangibles after the termination. (See the example below in the discussion of "Treatment of Certain Partnership Transactions.")

[37] No inference is intended whether any asset treated as a section 197 intangible under the bill is eligible for like-kind exchange treatment.

Treatment of certain partnership transactions

Generally, consistent with the rules described above for certain nonrecognition transactions, a transaction in which a taxpayer acquires an interest in an intangible held through a partnership (either before or after the transaction) will be treated as an acquisition to which the bill applies only if, and to the extent that, the acquiring taxpayer obtains, as a result of the transaction, an increased basis for such intangible.[38]

For example, assume that A, B and C each contribute $700 for equal shares in partnership P, which on January 1, 1993, acquires as its sole asset an amortizable section 197 intangible for $2,100. Assume that on January 1, 1997, (1) the sole asset of P is the intangible acquired in 1993, (2) the intangible has an unamortized basis of $1,500 and A, B, and C each have a basis of $500 in their partnership interests, and (3) D (who is not related to A, B, or C) acquires A's interest in P for $800. Under the bill, if there is no section 754 election in effect for 1997, there will be no change in the basis or amortization of the intangible and D will merely step into the shoes of A with respect to the intangible. D's share of the basis in the intangible will be $500, which will be amortized over the 12 years remaining in the amortization period for the intangible.

On the other hand, if a section 754 election is in effect for 1997, then D will be treated as having an $800 basis for its share of P's intangible. Under section 197, D's share of income and loss will be determined as if P owns two intangible assets. D will be treated as having a basis of $500 in one asset, which will continue to be amortized over the 12 remaining years of the original 16-year life. With respect to the other asset, D will be treated as having a basis of $300 (the amount of step-up obtained by D under section 743 as a result of the section 754 election) which will be amortized over a 16-year period starting with January of 1997. B and C will each continue to share equally in a $1,000 basis in the intangible and amortize that amount over the remaining 12-year life.

As an additional example, assume the same facts as described above, except that D acquires both A's and B's interests in P for $1,600. Under section 708, the transaction is treated as if P is liquidated immediately after the transfer, with C and D each receiving their pro rata share of P's assets which they then immediately contribute to a new partnership. The distributions in liquidation are governed by section 731. Under the bill, C's interest in the intangible will be treated as having a $500 basis, with a remaining amortization period of 12 years. D will be treated as having an interest in two assets: one with a basis of $1,000 and a remaining amortization period of 12 years, and the other with a basis of $600 and a new amortization period of 16 years.

As discussed more fully below, the bill also changes the treatment of payments made in liquidation of the interest of a deceased or retired partner in exchange for goodwill. Except in the case of payments made on the retirement or death of a general partner of a partnership for which capital is not a material income-producing

[38] This discussion is subject to the application of the anti-churning rules which are discussed below.

factor, such payments will not be treated as a distribution of partnership income. Under the bill, however, if the partnership makes an election under section 754, section 734 will generally provide the partnership the benefit of a stepped-up basis for the retiring or deceased partner's share of partnership goodwill and an amortization deduction for the increase in basis under section 197.

For example, using the facts from the preceding examples, assume that on January 1, 1997, A retires from the partnership in exchange for a payment from the partnership of $800, all of which is in exchange for A's interest in the intangible asset owned by P. Under the bill, if there is a section 754 election in effect for 1997, P will be treated as having two amortizable section 197 intangibles: one with a basis of $1,500 and a remaining life of 12 years, and the other with a basis of $300 and a new life of 16 years.

Treatment of certain reinsurance transactions

The bill applies to any insurance contract that is acquired from another person through an assumption reinsurance transaction (but not through an indemnity reinsurance transaction).[39] The amount taken into account as the adjusted basis of such a section 197 intangible, however, is to equal the excess of (1) the amount paid or incurred by the acquirer/reinsurer under the assumption reinsurance transaction,[40] over (2) the amount of the specified policy acquisition expenses (as determined under section 848 of the Code) that is attributable to premiums received under the assumption reinsurance transaction. The amount of the specified policy acquisition expenses of an insurance company that is attributable to premiums received under an assumption reinsurance transaction is to be amortized over the period specified in section 848 of the Code.

Treatment of amortizable section 197 intangible as depreciable property

For purposes of chapter 1 of the Internal Revenue Code, an amortizable section 197 intangible is to be treated as property of a character which is subject to the allowance for depreciation provided in section 167. Thus, for example, an amortizable section 197 intangible is not a capital asset for purposes of section 1221 of the Code, but an amortizable section 197 intangible held for more than one year generally qualifies as property used in a trade or business for purposes of section 1231 of the Code. As further examples, an amortizable section 197 intangible is to constitute section 1245 property, and section 1239 of the Code is to apply to any gain recognized upon the sale or exchange of an amortizable section 197 intangible, directly or indirectly, between related persons.

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[39] An assumption reinsurance transaction is an arrangement whereby one insurance company (the reinsurer) becomes solely liable to policyholders on contracts transferred by another insurance company (the ceding company). In addition, for purposes of the bill, an assumption reinsurance transaction is to include any acquisition of an insurance contract that is treated as occurring by reason of an election under section 338 of the Code.

[40] The amount paid or incurred by the acquirer/reinsurer under an assumption reinsurance transaction is to be determined under the principles of present law. (See Treas. Reg. sec. 1.817-4(d)(2).)

Treatment of certain amounts that are properly taken into account in determining the cost of property that is not a section 197 intangible

The bill does not apply to any amount that is properly taken into account under present law in determining the cost of property that is not a section 197 intangible. Thus, for example, no portion of the cost of acquiring real property that is held for the production of rental income (for example, an office building, apartment building or shopping center) is to be taken into account under the bill (i.e., no goodwill, going concern value or any other section 197 intangible is to arise in connection with the acquisition of such real property). Instead, the entire cost of acquiring such real property is to be included in the basis of the real property and is to be recovered under the principles of present law applicable to such property.

Modification of purchase price allocation and reporting rules for certain asset acquisitions

Sections 338(b)(5) and 1060 of the Code authorize the Treasury Department to promulgate regulations that provide for the allocation of purchase price among assets in the case of certain asset acquisitions. Under regulations that have been promulgated pursuant to this authority, the purchase price of an acquired trade or business must be allocated among the assets of the trade or business using the "residual method."

Under the residual method specified in the Treasury regulations, all assets of an acquired trade or business are divided into the following four classes: (1) Class I assets, which generally include cash and cash equivalents; (2) Class II assets, which generally include certificates of deposit, U.S. government securities, readily marketable stock or securities, and foreign currency; (3) Class III assets, which generally include all assets other than those included in Class I, II, or IV (generally all furniture, fixtures, land, buildings, equipment, other tangible property, accounts receivable, covenants not to compete, and other amortizable intangible assets); and (4) Class IV assets, which include intangible assets in the nature of goodwill or going concern value. The purchase price of an acquired trade or business (as first reduced by the amount of the assets included in Class I) is allocated to the assets included in Class II and Class III based on the value of the assets included in each class. To the extent that the purchase price (as reduced by the amount of the assets in Class I) exceeds the value of the assets included in Class II and Class III, the excess is allocable to assets included in Class IV.

It is expected that the present Treasury regulations which provide for the allocation of purchase price in the case of certain asset acquisitions will be amended to reflect the fact that the bill allows an amortization deduction with respect to intangible assets in the nature of goodwill and going concern value. It is anticipated that the residual method specified in the regulations will be modified to treat all amortizable section 197 intangibles as Class IV assets and that this modification will apply to any acquisition of property to which the bill applies.

Section 1060 also authorizes the Treasury Department to require the transferor and transferee in certain asset acquisitions to furnish information to the Treasury Department concerning the amount of any purchase price that is allocable to goodwill or going concern value. The bill provides that the information furnished to the Treasury Department with respect to certain asset acquisitions is to specify the amount of purchase price that is allocable to amortizable section 197 intangibles rather than the amount of purchase price that is allocable to goodwill or going concern value. In addition, it is anticipated that the Treasury Department will exercise its existing regulatory authority to require taxpayers to furnish such additional information as may be necessary or appropriate to carry out the provisions of the bill, including the amount of purchase price that is allocable to intangible assets that are not amortizable section 197 intangibles.

General regulatory authority

The Treasury Department is authorized to prescribe such regulations as may be appropriate to carry out the purposes of the bill including such regulations as may be appropriate to prevent avoidance of the purposes of the bill through related persons or otherwise. It is anticipated that the Treasury Department will exercise its regulatory authority where appropriate to clarify the types of intangible property that constitute section 197 intangibles.

Effective date

In general

The provision generally applies to property acquired after the date of enactment of the bill. As more fully described below, however, a taxpayer may elect (1) to apply the bill to all property acquired after July 25, 1991, or (2) to clarify the treatment of all section 197 intangibles acquired in certain "open taxable years". In addition, a taxpayer that does not make either of the above elections may elect to apply present law (rather than the provisions of the bill) to property that is acquired after the date of enactment of the bill pursuant to a binding written contract in effect on the date of enactment of the bill and at all times thereafter until the property is acquired. Finally, special "anti-churning" rules may apply to prevent taxpayers from converting existing goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not have been allowable under present law into amortizable property to which the bill applies.

Election to apply bill to property acquired after July 25, 1991

A taxpayer may elect to apply the bill to all property acquired by the taxpayer after July 25, 1991. If a taxpayer makes this election, the bill also applies to all property acquired after July 25, 1991, by any taxpayer that is under common control with the electing taxpayer (within the meaning of subparagraphs (A) and (B) of section 41(f)(1)) of the Code) at any time during the period that began on

November 22, 1991, and that ends on the date that the election is made.[41]

The election is to be made at such time and in such manner as may be specified by the Treasury Department,[42] and the election may be revoked only with the consent of the Treasury Department.

Special election to clarify the treatment of section 197 intangibles acquired during certain open taxable years

A taxpayer that acquired an "amortizable section 197 intangible" [43] on or before July 25, 1991 in an "open taxable year", would be allowed to make an election pursuant to which such taxpayer would be required, with respect to all "amortizable section 197 intangibles" acquired during an "open taxable year" for which a Federal income tax return has been filed before June 16, 1992 (a "return year") to amortize 75 percent of the basis of such intangibles that were actually claimed as amortizable on such taxpayer's Federal income tax return for the year of acquisition. The method and period of such amortization would be the same as reported by the taxpayer on such return. The remaining 25 percent of the basis of such intangibles as well as the entire basis of any section 197 intangibles acquired in such year that were not treated as amortizable on such return would be treated as non-amortizable goodwill and would only be recovered at the time that the trade or business to which the goodwill relates is disposed of (or becomes worthless). The allocation of basis between amortizable intangibles and non-amortizable intangibles as reflected on such return will be binding on the electing taxpayer and the IRS. For purpose of the rules described in this paragraph regarding the basis of intangibles claimed as amortizable and the allocation of basis on the return, an amended return for a return year shall be treated as a return, but only if filed on or before July 25, 1991. In addition, any closing agreement or settlement agreement entered into before June 16, 1992, shall be treated as a return for purposes of these rules.

If a taxpayer makes the election described in the preceding paragraph, such taxpayer will also be required to apply the rules of section 197, as contained in the bill, to all "amortizable section 197 intangibles" acquired prior to the date of enactment and during an "open taxable year" for which a return has not been filed prior to June 16, 1992. However, 25 percent of the adjusted basis of each such intangible shall for all purposes be treated as goodwill with

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[41] However, with certain exceptions, an amortization deduction is not to be allowed under the bill for goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not be allowable but for the provisions of the bill if: (1) the section 197 intangible is acquired after July 25, 1991; and (2) either (a) the taxpayer or a related person held or used the intangible on July 25, 1991; (b) the taxpayer acquired the intangible from a person that held such intangible on July 25, 1991, and, as part of the transaction, the user of the intangible does not change; or (c) the taxpayer grants the right to use the intangible to a person (or a person related to such person) that held or used the intangible on July 25, 1991. See below for a more detailed description of these "anti-churning" rules.

[42] It is anticipated that the Treasury Department will require the election to be made on the timely filed Federal income tax return of the taxpayer for the taxable year that includes the date of enactment of the bill.

[43] For purposes of the election, property is considered an "amortizable section 197 intangible" if it meets the requirements of new section 197 for amortization over 16 years. Taxpayers making the election will not be permitted to treat property acquired from a qualified research entity prior to the date of enactment as having been excluded from the definition of such section 197 property.

respect to which no deduction for amortization or depreciation is allowable. Thus, for example, 25 percent of the excess of purchase price over the amount properly allocable to assets that are not "amortizable section 197 intangibles" will be treated as nonamortizable goodwill; and 75 percent of such purchase price will be amortized on a straight line basis over 16 years.

For purposes of this election, an "open taxable year" is a taxable year for which either (1) the statute of limitations for assessment has not expired before June 16, 1992, and there has been no closing agreement or settlement agreement entered into before June 16, 1992 with respect to such year which resolves the treatment for such year of all deductions with respect to section 197 intangibles [44] or (2) as of June 16, 1992, a claim for refund is pending with the IRS or a refund suit is pending in a Federal court with respect to the proper federal income tax treatment of section 197 intangibles acquired in such year or another open taxable year. For purposes of the latter requirement, a claim for refund will be treated as pending on June 16, 1992, if prior to that date such a claim was properly filed by the taxpayer and denied by the Internal Revenue Service and the time for filing a suit for refund under section 6532 has not expired as of June 16, 1992. Notwithstanding the preceding rules, a taxable year will not be treated as an "open taxable year" if any subsequent year is not an open taxable year.[45] Thus the election only applies to the consecutive sequence of open taxable years ending with the year which includes the date of enactment.

Underpayments of tax that are attributable to the election will be subject to interest. The election must be made before January 1, 1993, in such manner as the Treasury Department may describe and will not be valid unless any additional tax due with respect to all return years together with all applicable interest is paid before January 1, 1993. The election can be revoked only with the consent of the Secretary.

In the case of two or more persons that, at any time between February 14, 1992 and the date of enactment are under common control within the meaning of subparagraphs (A) and (B) of section 41(f)(1), the election is valid only if made by the common parent corporation (or an equivalent person) and then applies to all such persons. In the case of a group of corporations that filed a consolidated return for any open taxable year, the parent corporation would be required to make the election for such taxable year. A corporation that is no longer part of a consolidated group would be eligible to make the election for all open taxable years that the corporation was not a member of a group that filed a consolidated return. The Treasury Department shall prescribe rules for applying the election to persons who were under common control for some but not all years to which the election might apply.

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[44] In addition, the statute of limitations for a taxable year is to be treated as expired for purposes of this election if, as of June 16, 1992, the taxpayer has agreed to extend the statute of limitations for such taxable year solely with respect to issues that do not involve the proper treatment for Federal income tax purposes of acquired intangibles that are defined as section 197 intangibles under the bill.

[45] In addition, a taxable year will not be considered an open year if no return had been filed before June 16, 1992 and the time for filing such return (including extensions) had expired by June 15, 1992.

The statute of limitations on the assessment of tax with respect to any taxable year affected by the election shall expire no sooner than two years after the election is made.

If a taxpayer makes the election, the anti-churning rules, described in more detail below, will apply to an acquisition of a section 197 intangible that is non-amortizable under current law, if such acquisition occurs after July 25, 1991, in an open taxable year which is not a return year.

Elective binding contract exception

A taxpayer may also elect to apply present law (rather than the provisions of the bill) to property that is acquired after the date of enactment of the bill if the property is acquired pursuant to a binding written contract that was in effect on the date of enactment and at all times thereafter until the property is acquired. This election may not be made by any taxpayer that is subject to either of the elections described above that apply the provisions of the bill to property acquired before the date of enactment of the bill.

The election is to be made at such time and in such manner as may be specified by the Treasury Department,[46] and the election may be revoked only with the consent of the Treasury Department.

Anti-churning rules

Special rules are provided by the bill to prevent taxpayers from converting existing goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not have been allowable under present law into amortizable property to which the bill applies.

Under these "anti-churning" rules, goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not be allowable but for the provisions of the bill may not be amortized as an amortizable section 197 intangible if: (1) the section 197 intangible is acquired by a taxpayer after the date of enactment of the bill; and (2) either (a) the taxpayer or a related person held or used the intangible at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill; (b) the taxpayer acquired the intangible from a person that held such intangible at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill and, as part of the transaction, the user of the intangible does not change; or (c) the taxpayer grants the right to use the intangible to a person (or a person related to such person) that held or used the intangible at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill. The anti-churning rules, however, do not apply to the acquisition of any intangible by a taxpayer if the basis of the intangible in the hands of the taxpayer is determined under section 1014(a) (relating to property acquired from a decedent).

[46] It is anticipated that the Treasury Department will require the election to be made on the timely filed Federal income tax return of the taxpayer for the taxable year that includes the date of enactment of the bill.

For purposes of the anti-churning rules, a person is related to another person if: (1) the person bears a relationship to that person which would be specified in section 267(b)(1) or 707(b)(1) of the Code if those sections were amended by substituting 20 percent for 50 percent; or (2) the persons are engaged in trades or businesses under common control (within the meaning of subparagraphs (A) and (B) of section 41(f)(1) of the Code). A person is treated as related to another person if such relationship exists immediately before or immediately after the acquisition of the intangible involved.

In addition, in determining whether the anti-churning rules apply with respect to any increase in the basis of partnership property under section 732, 734, or 743 of the Code, the determinations are to be made at the partner level and each partner is to be treated as having owned or used the partner's proportionate share of the partnership property. Thus, for example, the anti-churning rules do not apply to any increase in the basis of partnership property that occurs upon the acquisition of an interest in a partnership that has made a section 754 election if the person acquiring the partnership interest is not related to the person selling the partnership interest.[47]

These "anti-churning" rules are not to apply to any section 197 intangible that is acquired from a person with less than a 50-percent relationship to the acquirer to the extent that: (1) the seller recognizes gain on the transaction with respect to such intangible; and (2) the seller agrees, notwithstanding any other provision of the Code, to pay a tax on such gain which, when added to any other Federal income tax imposed on such gain, equals the product of such gain and the highest rate of tax imposed by section 1 or 11 of the Code, whichever is applicable. The seller is treated as satisfying the second requirement if the excess of (1) the total tax liability for the year of the transaction over (2) what its tax liability for such year would have been had the sale of the intangible (but not the remainder of the transaction) been excluded from the computation equals or exceeds the product of the gain on that asset times the relevant maximum rate.

The bill also contains a general anti-abuse rule that applies to any section 197 intangible that is acquired by a taxpayer from another person. Under this rule, a section 197 intangible may not be amortized under the provisions of the bill if the taxpayer acquired the intangible in a transaction one of the principal purposes of which is to (1) avoid the requirement that the intangible be acquired after the date of enactment of the bill or (2) avoid any of the anti-churning rules described above that are applicable to goodwill, going concern value, or any other section 197 intangible for which

[47] In addition to these rules, it is anticipated that rules similar to the anti-churning rules under section 168 of the Code will apply in determining whether persons are related. (See Prop. Treas. Reg. 1.168-4 (February 16, 1984).) For example, it is anticipated that a corporation, partnership, or trust that owned or used property at any time during the period that begins on July 25, 1991, and that ends on the date of enactment of the bill and that is no longer in existence will be considered to be in existence for purposes of determining whether the taxpayer that acquired the property is related to such corporation, partnership, or trust.

As a further example, it is anticipated that in the case of a transaction to which section 338 of the Code applies, the corporation that is treated as selling its assets will not to be considered related to the corporation that is treated as purchasing the assets if at least 80 percent of the stock of the corporation that is treated as selling its assets is acquired by purchase after July 25, 1991.

a depreciation or amortization deduction would not be allowable but for the provisions of the bill.

Finally, the special rules described above that apply in the case of a transactions described in section 332, 351, 361, 721, 731, 1031, or 1033 of the Code also apply for purposes of the effective date. Consequently, if the transferor of any section 197 property is not allowed an amortization deduction with respect to such property under this provision, then the transferee is not allowed an amortization deduction under this provision to the extent of the adjusted basis of the transferee that does not exceed the adjusted basis of the transferor. In addition, this provision is to apply to any subsequent transfers of any such property in a transaction described in section 332, 351, 361, 721, 731, 1031, or 1033.

3. MODIFY SPECIAL TREATMENT OF CERTAIN LIQUIDATION PAYMENTS (SEC. 303 OF THE BILL AND SECS. 736(b) AND 751(c) OF THE CODE)

Present law

Payments for purchase of goodwill and accounts receivable

A current deduction generally is not allowed for a capital expenditure (*i.e.*, an expenditure that yields benefits beyond the current taxable year). The cost of goodwill acquired in connection with the assets of a going concern normally is a capital expenditure, as is the cost of acquiring accounts receivable. The cost of acquiring goodwill is recovered only when the goodwill is disposed of, while the cost of acquiring accounts receivable is taken into account only when the receivable is disposed of or becomes worthless.

Payments made in liquidation of partnership interest

The tax treatment of a payment made in liquidation of the interest of a retiring or deceased partner depends upon whether the payment is made in exchange for the partner's interest in partnership property. A liquidating payment made in exchange for such property is treated as a distribution by the partnership (sec. 736(b)). Such distribution generally results in gain to the retiring partner only to the extent that the cash distributed exceeds the partner's adjusted basis in his partnership interest.

A liquidating payment not made in exchange for the partner's interest in partnership property receives either of two possible treatments. If the amount of the payment is determined without reference to partnership income, it is treated as a guaranteed payment and is generally deductible (sec. 736(a)(2)). If the amount of payment is determined by reference to partnership income, the payment is treated as a distributive share of partnership income, thereby reducing the distributive shares of other partners (which is equivalent to a deduction) (sec. 736(a)(2)).

A special rule treats amounts paid for goodwill of the partnership (except to the extent provided in the partnership agreement) and unrealized receivables as not made in exchange for an interest in partnership property (sec. 736(b)(2)(B)). Thus, such amounts may be deductible. Unrealized receivables include unbilled amounts, accounts receivable, depreciation recapture, market discount, and certain other items (sec. 751(c)).

Sale or exchange of a partnership interest

The sale or exchange of a partnership interest results in capital gain or loss to the transferor partner, except to the extent that ordinary income or loss is recognized with respect to the partner's share of the partnership's unrealized receivables and substantially appreciated inventory items (sec. 741). It is often unclear whether a payment by a partnership to a retiring partner is made in sale or exchange of, or in liquidation of, a partnership interest.

Reasons for change

In general

By treating a payment for unstated goodwill and unrealized receivables as a guaranteed payment or distributive share, present law in effect permits a deduction for an amount that would otherwise constitute a capital expenditure. This treatment does not measure partnership income properly. It also threatens to erode the rule requiring capitalization of such payments generally. Under present law, a prospective buyer of a business may structure the transaction so as to currently deduct such an amount by first entering into a partnership with the seller and then liquidating the seller's partnership interest.

Section 736 was intended to simplify the taxation of payments in liquidation. Instead, it has created confusion as to whether a particular payment is a payment in liquidation or is made pursuant to a sale of the partnership interest to the continuing partners. The proposal reduces this confusion by eliminating a primary difference between sales and liquidations.

The special treatment of goodwill was apparently predicated on the assumption that the adverse positions of the taxpayers will result in a stated price equal to the true value of the goodwill. That assumption is false. If the value of the preferential rate (if any) and the income deflection are not equal, the stated goodwill and total retirement payments will likely be set so as to maximize the combined tax savings for both retiring and continuing partners.

It is recognized, however, that general partners in service partnerships do not ordinarily value goodwill in liquidating partners. Accordingly, such partners may continue to receive the special rule of present law.

Unrealized receivables

When originally enacted, the term "unrealized receivables" was limited to unbilled amounts and accounts receivable. The tax deferral resulting from immediate deduction of amounts paid for these items is relatively short because payment is usually received in the near future. Such deferral is considerably longer, however, with respect to the deduction of other items now included in the expanded definition of unrealized receivables, such as depreciation recapture on business assets, which are slow to give rise to ordinary income.

Explanation of provision

In general

The bill generally repeals the special treatment of liquidation payments made for goodwill and unrealized receivables. Thus, such payments would be treated as made in exchange for the partner's interest in partnership property, and not as a distributive share or guaranteed payment that could give rise to a deduction or its equivalent. The bill does not change present law with respect to payments made to a general partner in a partnership in which capital is not a material income-producing factor.[48] In addition, the bill does not affect the deductibility of compensation paid to a retiring partner for past services.

Unrealized receivables

The bill also repeals the special treatment of payments made for unrealized receivables (other than unbilled amounts and accounts receivable) for all partners. Such amounts would be treated as made in exchange for the partner's interest in partnership property. Thus, for example, a payment for depreciation recapture would be treated as made in exchange for an interest in partnership property, and not as a distributive share or guaranteed payment that could give rise to a deduction or its equivalent.

Effective date

The provision generally applies to partners retiring or dying after February 14, 1992. The provision does not apply to any partner who retires after February 14, 1992, if a written contract to purchase the partner's interest in the partnership was binding on February 14, 1992, and at all times thereafter until such purchase. For this purpose, a written contract is to be considered binding only if the contract specifies the amount to be paid for the partnership interest and the timing of any such payments.

4. REQUIRE REPORTING OF TAXPAYER IDENTIFICATION NUMBERS OF PARTIES IN SELLER-FINANCED MORTGAGE TRANSACTIONS (SEC. 304 OF THE BILL AND SEC. 6109 OF THE CODE)

Present law

Taxpayers are generally allowed an itemized deduction from adjusted gross income for the amount of qualified residence interest paid. If qualified residence interest is paid to an individual, the name and address (but not the taxpayer identification number)[49] of the interest recipient must be reported on Schedule A of the payor's tax return.

Individuals receiving taxable interest in excess of $400 are required to report the amounts received and the names (but not the addresses or taxpayer identification numbers) of the payors on Schedule B of the payee's tax return.

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[48] The determination of whether capital is a material income-producing factor would be made under principles of present and prior law (*e.g.*, sections 401(c)(2) and 911(d) of the Code and old section 1348(b)(1)(A) of the Code).

[49] An individual's taxpayer identification number is generally that individual's Social Security number.

Reasons for change

The committee believes that it is appropriate to increase the effectiveness of IRS utilization of information relating to seller-financed mortgages.

Explanation of provision

If any taxpayer claims a deduction for qualified residence interest on any seller-provided financing, such taxpayer (the buyer) shall include on his or her tax return the name, address, and taxpayer identification number of the person (the seller) to whom the interest is paid or accrued. In general, this information must be furnished on Schedule A of the buyer's tax return for every year in which the buyer deducts this interest.

If any person receives or accrues interest from seller-provided financing, such person (the seller) shall include on his or her tax return the name, address, and taxpayer identification number of the person (the buyer) from whom the interest is received or accrued. In general, this information must be furnished on Schedule B of the seller's tax return for every year in which the seller is required to include this interest in income.

If any person involved in seller-provided financing is required to include on his or her tax return the taxpayer identification number of another person, such other person is required to furnish his or her taxpayer identification number to such person. Information would not be required to be reported under this provision to the extent it would be duplicative of existing information reporting requirements.

Failure to meet the requirements for information reporting described above are subject to information reporting penalties under section 6723. In general, these penalties are $50 for each failure.

The committee anticipates that all parties to real estate closings will make every effort to inform both buyers and sellers of the requirements of this provision, and will also facilitate (to the maximum extent possible) the exchange of taxpayer identification numbers between buyers and sellers.

Effective date

The provision is effective for taxable years beginning after December 31, 1991.

5. INCREASE EXCISE TAX ON CERTAIN OZONE-DEPLETING CHEMICALS (SECS. 305 OF THE BILL AND SECS. 4681–4682 OF THE CODE)

Present law

An excise tax is imposed on certain ozone-depleting chemicals. The amount of tax generally is determined by multiplying the base tax amount applicable for the calendar year by an ozone-depleting factor assigned to the chemical. Certain chemicals are subject to a reduced rate of tax for years prior to 1994.

Between 1992 and 1995 there are two base tax amounts applicable, depending upon whether the chemicals were initially listed in the Omnibus Budget Reconciliation Act of 1989 or whether they were newly listed in the Omnibus Budget Reconciliation Act of 1990. The base tax amount applicable to initially listed chemicals is

$1.67 per pound for 1992, $2.65 per pound for 1993 and 1994, and an additional 45 cents per pound per year for each year thereafter. The base tax amount applicable to newly listed chemicals is $1.37 per pound for 1992, $1.67 per pound for 1993, $3.00 per pound for 1994, $3.10 per pound for 1995, and an additional 45 cents per pound per year for each year thereafter.

Reasons for change

On February 11, 1992, President Bush announced that, in response to recent scientific findings, the United States unilaterally will accelerate the phaseout of substances that deplete the Earth's ozone layer. The President announced that the production of major CFCs, halons, methyl chloroform, and carbon tetrachloride generally will be eliminated by December 31, 1995. The President noted that the tax on ozone-depleting chemicals has helped the United States achieve a more rapid reduction in use of such chemicals than that called for under the Montreal Protocol on Substances that Deplete the Ozone Layer ("Montreal Protocol").

In light of the recent scientific evidence, the President's action, and in recognition of the importance of the tax on ozone-depleting chemicals as an economic incentive, the committee believes it is important to enhance the conservation effort and speed the search for safe substitutes by increasing the base rate of tax on ozone-depleting chemicals. The committee believes an increase in the base rate of tax will help market forces in finding substitutes. In addition, the committee is concerned that the market prices for ozone-depleting chemicals currently do not reflect many of the environmental and other social costs associated with their use. As a result, the quantities of these chemicals being produced and used may be grater than optimal. The committee believes the tax on ozone-depleting chemicals helps foster reduced use of ozone-depleting chemicals.

Explanation of provision

The bill increases the base tax amount of both initially listed chemicals and newly listed chemicals. The bill increases the base tax amount of initially listed and newly listed chemicals by $0.15 per pound for 1992, by $0.25 per pound for 1993, by $0.35 per pound for 1994, and by $0.45 per pound for 1995. For each year after 1995, the increase in the base tax amount for both initially and newly listed chemicals is $0.45 per pound. These increases in the base tax amounts are in addition to those currently scheduled to occur under present law, including the $0.45 per pound per year increases for years after 1994 for initially listed chemicals and the $0.45 per pound per year increases for years after 1995 for newly listed chemicals.

Effective date

The provision is effective for taxable chemicals sold (or used) on or after October 1, 1992. Floor stocks taxes are imposed on taxable chemicals held on the effective dates of changes in the base tax amount.

III. Budget Effects of the Bill

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the estimated budget effects of the Committee amendment to H.R. 3040, as amended and reported by the Committee on Finance.

The budget effects of the bill for fiscal years 1992-1997 are shown in the following table:

SENATE FINANCE COMMITTEE.—ESTIMATED REVENUE EFFECTS OF H.R. 3040, AS REPORTED BY THE COMMITTEE ON JUNE 16, 1992—FISCAL YEAR 1992–1997

[In billions of dollars]

Item	Effective	1992	1993	1994	1995	1996	1997	1992–97
Extenders and luxury tax repeal:								
A. 18-month extension of certain expiring tax provisions:								
1. Employer-provided educational assistance	July 1, 1992	−0.062	−0.244	−0.239				−0.545
2. Group legal services	July 1, 1992	−0.027	−0.110	−0.032				−0.169
3. Health insurance for self-employed	July 1, 1992	−0.058	−0.247	−0.263				−0.568
4. Mortgage revenue bonds and mortgage credit certificates (with modifications)	July 1, 1992	−0.003	−0.041	−0.082	−0.092	−0.087	−0.083	−0.388
5. Qualified small-issue bonds (1)	July 1, 1992	−0.001	−0.025	−0.049	−0.054	−0.048	−0.045	−0.223
6. Research and experimentation tax credit	July 1, 1992	−0.184	−0.823	−0.498	−0.135	−0.070	−0.034	−1.744
7. Low-income housing tax credit (with modifications)	July 1, 1992	−0.021	−0.079	−0.178	−0.278	−0.345	−0.379	−1.280
8. Targeted jobs tax credit (with modifications)	July 1, 1992	−0.047	−0.157	−0.191	−0.114	−0.054	−0.027	−0.589
9. Orphan drug tax credit	July 1, 1992	−0.001	−0.006	−0.004				−0.011
10. Minimum tax exemption for gifts of all appreciated property	July 1, 1992	−0.006	−0.040	−0.057	0.022	−0.008	−0.006	−0.095
11. Excise tax on certain vaccines for the Vaccine Injury Compensation Fund	Jan. 1, 1993	(2)	(2)	(2)	(2)	(2)	(2)	(2)
12. Permanent extension of Railroad Retirement Tier II transfers								
B. Luxury excise tax repeal; diesel fuel tax on motorboats:								
1. Repeal tax on boats, airplanes, jewelry, furs; index automobiles	(3)	−0.015	−0.065	−0.087	−0.102	−0.119	−0.135	−0.523
2. Repeal diesel fuel tax exemption for motorboats	Oct. 1, 1992		0.028	0.030	0.030	0.028	0.028	0.144
Subtotals: revenue-losing provisions	Oct. 1, 1992	−0.425	−1.809	−1.650	−0.723	−0.703	−0.681	−5.991

SENATE FINANCE COMMITTEE.—ESTIMATED REVENUE EFFECTS OF H.R. 3040, AS REPORTED BY THE COMMITTEE ON JUNE 16, 1992—FISCAL YEAR 1992–1997—Continued

[In billions of dollars]

Item	Effective	1992	1993	1994	1995	1996	1997	1992–97
Revenue-raising provisions:								
1. Permanently extend 5% increase in corporate estimate tax payment safe-harbor rate	tyba Dec. 31, 1996						3.024	3.024
2. Amoritization of intangibles (including retroactive election for 75% of return position in open years)		0.715	4.326	0.045	−0.328	−0.831	−1.513	2.413
3. Reporting for seller-financed mortgages	tyba Dec. 31, 1991	0.023	0.091	0.107	0.114	0.122	0.131	0.588
4. Increase excise tax on certain ozone-depleting chemicals(4)	Oct. 1, 1992		0.039	0.069	0.071	0.060	0.052	0.291
Grand totals		0.313	2.647	−1.429	−0.866	−1.352	1.013	0.325

[1] Estimate includes interaction with mortgage bond extension.

[2] Extension of the vaccine excise taxes is assumed in the CBO baseline; therefore, an extension of the Vaccine Injury Compensation Fund has no revenue effect.

[3] Effective dates: Jan. 1, 1992 = Repeal tax on boats, planes, furs, jewelry; July 1, 1992 = Index automobiles.

[4] The energy bill increased the base tax rate per pound for originally listed chemicals by $0.18 for 1992, $0.10 for 1993, $1.00 for 1994, $1.45 for 1995 and for each year thereafter; and increased the base tax rate per pound for originally listed chemicals by $0.48 for 1992, $1.08 for 1993, $0.65 for 1994, $1.45 for 1995 and for each year thereafter. For this bill, increase the base tax rate per pound for newly listed chemicals by $0.15 for 1992, $0.25 for 1993, $0.35 for 1994, $0.45 for 1995 and for each year thereafter. Resulting tax rates for all listed chemicals will be $2.00 per pound for 1992, $3.00 per pound for 1993, $4.00 per pound for 1994, $5.00 per pound for 1995, and increase by $0.45 per pound per year thereafter.

Note: Joint Committee on Taxation. Details may not add to totals due to rounding.

Legend for "Effective" column: tyba = taxable years beginning after.

IV. Regulatory Impact 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 bill as reported by the Committee on Finance.

The bill provides temporary extensions of certain expiring tax provisions and a permanent extension of the General Fund transfer to the Railroad Retirement Tier 2 Fund. The bill also provides for repeal of the luxury excise tax on boats, aircraft, jewelry, and furs and indexing of the luxury excise tax on automobiles. In addition, the bill provides revenue offsets so that the bill is deficit neutral for fiscal year 1992 and 1993 and over the fiscal year 1992-1997 period: imposing the diesel fuel excise tax on noncommercial motor boats; modifying the estimated tax payment rules for large corporations; revising the tax treatment of goodwill and other intangible assets; and increasing the excise tax on certain ozone-depleting chemicals.

B. Other Matters

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 of the committee on the motion to report the bill. The bill, as amended, was ordered reported by voice vote.

TAX EXPENDITURES

In compliance with Section 308(a)(2) of the Budget Act, the committee states that the bill as amended involves increased tax expenditures with respect to the income tax decrease provisions [and a reduction in tax expenditures with respect to the change in the tax treatment of intangibles]. (See revenue table in Part III of this report.)

CONGRESSIONAL BUDGET OFFICE ESTIMATES

In accordance with Section 403 of the Budget Act, the committee advises that the Congressional Budget Office has reviewed the committee budget estimates (included in Part III of this report), and submitted the following statement:

U.S. Congress,
Congressional Budget Office,
Washington, DC, June 18, 1992.

Hon. Lloyd Bentsen,
Chairman, Committee on Finance,
U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed H.R. 3040, a bill extending certain expiring tax preferences and repealing certain luxury taxes, as amended and ordered reported by the Senate Committee on Finance on June 16, 1992. The

Joint Committee on Taxation (JCT) estimates that the bill, as amended by the Finance Committee, would increase receipts by $313 million in fiscal year 1992 and by $325 million over the 1992 through 1997 period.

The bill would extend certain provisions expiring in 1992 that offer preferential tax treatment for the following: employer-provided educational assistance, group legal services, health insurance for the self-employed, mortgage bonds and mortgage credit certificates, qualified small-issue bonds, research and experimentation expenses, the production of low-income rental housing, targeting jobs for certain groups, the development of orphan drugs, and gifts of appreciated property. Each of these provisions expires under current law on June 30, 1992, and would be extended through December 31, 1993. The bill would also extend for two years (through December 31, 1994) the excise tax on certain vaccines that finance the Vaccine Injury Compensation Fund and permanently extend the general fund transfers of income taxes collected on Railroad Retirement Tier II benefits. Finally, H.R. 3040 would repeal the luxury tax on boats, airplanes, jewelry, and furs, and index for inflation the luxury tax on automobiles.

To offset the loss in receipts from these provisions, H.R. 3040 would repeal the diesel fuel tax exemption for motorboats, modify the estimated tax payment rules for large corporations, change rules covering the amortization of intangibles, require the reporting of seller-financed mortgages, and increase the excise tax on certain ozone depleting chemicals.

All of these provisions would be subject to pay-as-you-go procedures. The Joint Committee on Taxation has estimated the effect of the bill on receipts, and CBO concurs with those estimates. The JCT estimates that the bill would increase receipts by $313 million in fiscal year 1992 and by $325 million over the 1992 through 1997 period. The budget effects are summarized below.

BUDGET EFFECTS OF H.R. 3040

[By fiscal year, in millions of dollars]

	1992	1993	1994	1995	1996	1997
Estimated outlays						
Estimated net revenues	313	2,647	1,429	−866	−1,352	1,013

H.R. 3040 would affect receipts and thus would be subject to pay-as-you-go procedures under Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985. The pay-as-you-go scoring, however, is the same as the total budget impact of the bill.

PAY-AS-YOU-GO EFFECTS

[By fiscay year, in millions of dollars]

	1992	1993	1994	1995
Change in outlays	(1)	(1)	(1)	(1)
Change in receipts	313	2,647	−1,429	−866

[1] Not applicable.

If you wish further details, please feel free to contact me or your staff may wish to contact John Stell at 226-2720.

Sincerely,

ROBERT D. REISCHAUER,
Director.

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 the Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the Committee amendment as reported by the Committee on Finance).

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