EXECUTIVE COMMITTEE MEETING TO CONSIDER S.2, THE JOBS AND GROWTH TAX ACT OF 2003

THURSDAY, MAY 8, 2003

U.S. Senate,

Committee on Finance,

Washington, DC.

The meeting was convened, pursuant to notice, at 10:18 a.m., in room SH-216, Hart Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Hatch, Nickles, Lott, Snowe, Kyl, Thomas, Santorum, Frist, Smith, Bunning, Baucus, Rockefeller, Daschle, Breaux, Conrad, Graham, Jeffords, Bingaman, Kerry, and Lincoln.

Also present: Kolan Davis, Staff Director and Chief Counsel; Theodore Totman, Deputy Staff Director; Jeff A. Forbes, Democratic Staff Director; Mark Prater, Chief Tax Counsel; Edgar McClellan, Tax Counsel; Steve Robinson, Chief Social Security Analyst; Russ Sullivan, Democratic Chief Tax Counsel; Carla Martin, Chief Clerk, and Amber Williams, Deputy Chief Clerk.

Also present: George Yin, Chief of Staff designee, Joint Committee on Taxation; Andrew Lyon, Deputy Assistant Secretary for Tax Administration, Treasury Department; and Gregory Jenner, Deputy Assistant Secretary for Tax Policy, Treasury Department.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The Chairman. Good morning, everybody.

Obviously, I think most everyone knows that we had a vote at 9:30, then we had a ceremony for some ambassadors, so we are late getting started. There is really a good deal of people here already, and we are going to move forward.

We will have opening statements in the tradition of this committee, of any length that I would choose and Senator Baucus would choose. Then we are going to let any member of the committee speak on the bill, or any subject connected with the bill that they want to.

I would ask, without a firm rule, if members would consider maybe limiting it to three to five minutes. But we know this is a very important piece of legislation, one of the three most important issues we are going to be dealing with out of this committee, at least for the first nine months of this year, so we want to make sure that everybody has a chance to speak.

Then what we will do is go through the walk-through at that point, then after that we will go for amendments. So, I want to thank staff for working hard yesterday to put the final adjustments together. I want to thank

Senator Baucus for our communications during this process that gets us to where we are.

We gather today to establish a set of tax policies to stimulate economic recovery and create over one million new jobs. Growth in the economy and creation of new jobs to get the economy moving again are worthy and needed goals.

Several weeks ago, the Senate agreed upon the size of the reconciled tax relief cut for jobs and growth. Any disagreement surrounding today's mark-up pertains only to the best means for achieving our agreed-upon economic recovery goals.

Lengthy conversations with most of our committee members, including Senator Baucus, lead me to conclude that the large majority of the members of our committee agree on at least three-quarters of this tax package before us.

Our members are in collective agreement regarding accelerating the child tax credit, marriage penalty relief, expansion of the 10 percent bracket, almost all of the marginal tax rates, the exception being the top rate, expanding small business expensing, and providing much-needed AMT relief.

On that point of AMT relief, I would like to say that the mark today actually goes further than anticipated and

ensures that fewer Americans will be subject to the AMT as a result of this legislation through 2005.

Unfortunately, we were unable to solve the problem entirely beginning in 2006, but I would like to continue to work on that issue to ensure that we continue moving in the right direction.

These six provisions that I have outlined here where I think that there is some agreement, and bipartisan agreement, comprise approximately $300 billion of the total package of economic recovery proposals that are on the table today, and the three-fourths of the bill that I boldly say has bipartisan support.

Unfortunately, key philosophical differences within this committee prevent the committee from reaching a general consensus with respect to the remaining one-fourth of today's modified mark.

This is not an unusual circumstance in the committee's history or the Congress' history. Over the last several decades, Democrats and Republicans have held widely diverging views about the best tax policies for getting our economy back on track during times of economic downturn.

The most recent example occurred in the fall of 2001, with the Democratic Caucus stimulus bill. At that mark-up, we laid out our philosophical differences with the

then majority. Knowing the outcome in advance, we had a very lively debate throughout that committee's discussion.

I would like to note, however, for the record, that Republicans at that time did not offer any amendments. The story might be different today for the other party, and that is their right.

If you look back to the recession of 1991-1992, Democratic majorities pushed through stimulus bills on party line votes. These partisan splits were also true in tough economic times of the 1980s and 1970s.

I say this, not in a critical way, but in a regretful way. There is much that we agree on, but if history is our guide, it is likely that we split in attempts to remedy the economy. I wish it were not so.

Thank God these honest, respectful differences of opinion have never soured the cooperative spirit that Senator Baucus and I enjoy in working together.

Views on using fiscal policy to impact the U.S. economy will continue to vary widely, and reasonable and very intelligent minds may continue to disagree regarding the best approach.

The important point is, we share a common goal, to see our U.S. economy strengthened by tax relief policies that we offer as legislators, particularly those that

show direct job creation.

I believe that we put forth today a balanced package of consumption and investment incentives that will provide short-term stimulus and the building blocks for meaningful future economic growth.

In my view, Republicans and Democrats have disagreed on only two tax components of the President's plan: inclusion of dividends and acceleration of top rate reductions.

Although it took some time and it took considerable effort to reach a consensus, the mark before us includes a dividend proposal that represents a reasonable compromise from what the President outlined in January, and takes into account the Senate's budgetary framework.

While not an absolute victory against double taxation, the proposal is reported to cover 86 percent of dividend-receiving taxpayers and is a good step in the effort to eliminate economic distortions resulting from that tax policy framework.

When in full effect, this policy would ensure that dividends would be subject to a top rate of 28 percent. All other ordinary income would be subject to the top rate of 35 percent.

This means dividend income would enjoy a significant preference over other forms of periodic investment

income, like interest.

In accelerating the top rate--which incidentally only amounts to 7 percent of the total cost of the package--I caution us against looking exclusively at the number of taxpayers impacted by those rates.

Such analysis fails to tell a complete story about the efficiency and efficacy of lowering top rates and seems to focus only on who gets what in a distributive sense.

In my opinion, the better way to think about it is to focus, first, on what most efficiently changes behavior, what provides incentives for the creation of jobs, and, three, what has the largest multiplier effect upon our economy. That was the message that I heard during the collaborative meetings last week of our committee members on these issues.

Distributional analyses also ignore the fact that successful businesses, meaning profitable businesses that pay proportionately higher taxes in the higher marginal rates, are the ones who will disproportionately add the most labor and capital.

This is an important point to keep in mind. Recent analysis suggests that a 5-percentage-point reduction in the top marginal rate may increase small business investment by as much as 10 percent.

The U.S. Treasury Department has indicated that 80 percent of the benefits from the top rate acceleration would be used by small business. Small businesses are the engine of growth in our economy, and in the recent past have been the source of the most newly-created jobs.

I also continue to believe that it is important to ensure that small-town small businesses do not operate at a competitive disadvantage vis-a-vis large corporations because they are forced to pay a higher marginal income tax rate which non-incorporated small businesses now pay if they reach the 38 percent bracket.

Currently, successful small businesses then have that 10 percent rate penalty when compared to these bigger businesses. Even common sense would tell us that this does not make good economic sense.

We also provide state fiscal relief in this mark. Several Senators, both on the Finance Committee and in my own Republican Caucus, have indicated that they view State fiscal relief as a key component to the overall deal on taxes and growth.

So to meet that need and that request, I crafted the fiscal relief section of my mark to accommodate a debate on this issue when we get to the floor. My provision would provide a placeholder of $20 billion for grants to State and local governments.

These funds could be used for education, health care, law enforcement, and other essential government services. Many members, both on and off the Finance Committee, have worked on this issue. To accommodate as many people as I could, I believe that addressing this issue on the floor makes the most sense.

I look forward to continuing to work with my colleagues on this important issue when we get to the floor, and I will be helping that process along.

In closing, I once again make reference to my partner, Senator Baucus, for his continued effort to work with me, despite our inabilities to find common ground on all of the elements of this economic recovery package.

I look forward to continuing to work through our differences to produce legislation that will hopefully get things moving again as quickly and as efficiently as possible to create jobs. I thank you.

Now I turn to Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator Baucus. Thank you very much, Mr. Chairman. I appreciate and particularly thank you for the way you have approached this mark-up.

Mr. Chairman, you have got a difficult job, I know.

The Chairman. You have been there.

Senator Baucus. But you have always conducted the committee's business openly, fairly, and civilly, with courtesy, and I, for one, appreciate that. I know I speak for the rest of my colleagues on this side of the aisle by so stating.

As well, you approach the job with an openness and a willingness to work across the aisle, and you have tried to address the concerns, I know, of all members. I appreciate that, especially.

The Finance Committee and the Senate works best when we work together toward a joint product with broad support from both sides. This committee has a long and deserved reputation for working together cooperatively, and that tradition has served us quite well.

I know that that is your inclination, Mr. Chairman, to reach an agreement here. That is the Iowa way, in many respects. But I also know that circumstances,

particularly on your side of the aisle, made that impossible at this point. But this is only Thursday, we have many more days to go, and I hope we can reach an agreement.

Even though we are at this point where it is basically not a bipartisan bill, I believe it is not too late for us to continue to work in the bipartisan tradition.

Let me just take a few moments to discuss why we are here today, a few words about the President's proposal, and the response that we in the Congress have an obligation, I think, to render.

Why are we here today? In the first instance, we are here today because the Budget Resolution directs us to. The Resolution tells us that, by no later than May 8 we must report a reconciliation bill, so we are carrying out our duty under that budget process.

We are also here because the times demand it. On a Montana ranch, when the grasses have burned dry and there is just dust in the air, the rancher has got to take steps to feed and protect his herd. When the drought hits, times are tough. No Montana rancher, in that circumstance, would fail to dig down deeper and try to find a creative way to make ends meet.

On a larger scale, we are here today because the

American economy demands it. There is a drought in the American economy and we need to act.

Finally, the government reported that the unemployment rate jumped to 6 percent. Since just two years ago January, the private sector has lost more than 2.5 million jobs. The economy has lost more than a half a million jobs in the last three months alone.

We now have the fewest number of jobs in 41 months. Since January of two years ago, the economy has grown by an anemic average of 1.5 percent, far below the post-World War II average.

Businesses are telling me they are not investing because of so much uncertainty, too much over-capacity, and consumers who drive most of our economy are not buying. They, too, are uncertain.

So we are here today because the economy demands that we work to create jobs, to increase consumer confidence, investment confidence, to rebuild our economy, to rebuild America.

That, in turn, should bring us to several specific goals. We should seek policies that help the economy growth. They should take effect as soon as possible. They should not undermine our long-term fiscal situation.

That is, we should not add needless debt, additional burdens on our children and grandchildren. We must avoid

raising, potentially, mortgage interest rates on down the road. We should do what we can now to prevent that from happening.

These policies should spread their benefits widely among all taxpayers. We are all Americans together. All should benefit, not just a special elite.

Now, let me turn to the President's proposal and to the Congressional response. The President proposes a budget that, under the constitution, Congress legislates. We do not merely rubber-stamp the President's budget. We have a job to do.

After all, our founding fathers created our branch of government. The legislative article is Article I. It is the executive article, Article II, which is Article II, the second article.

One could say, therefore, that the legislative article has some primacy, at least with respect to legislating, and it is the executive branch which executes the laws that Congress passes.

Many of the President's proposals do command broad support. They may not be the most efficient stimulative proposals possible, but they should increase consumer demand, and I, for one, support them.

Specifically, I support helping families meet their costs by increasing the child credit to $1,000. I

support speeding up relief for the marriage penalty, as well as expanding the 10 percent bracket to give relief to most taxpayers and help most taxpayers spend. Also, I support ensuring that we do not worsen the difficulties created by the AMT.

I am pleased that your mark, Mr. Chairman, includes something on each of those items. But I think Congress has also a role to temper and improve the President's proposals. From my perspective, several areas are key.

First, the amount of the tax cut package is critical. The absence of fiscal responsibility over the long term affects long-term interest rates today. We have a duty to be responsible. We must not worsen interest rates and dampen economic growth by passing an irresponsibly large package.

In January of 2001, the Congressional Budget Office projected surpluses of $5.6 trillion for the next decade. Now, CBO projects the President's budget will result in deficits of $2.1 trillion for the same period. That is a swing of almost $8 trillion over two years. Recent projections make these projections look overly optimistic.

Our National Balance of Payments bill with other countries is closer to becoming due. It is widening and it is closer to becoming due. The dollar is declining

against the euro. Could it be that investors are beginning to question America's long-term economic policies?

Clearly, our fiscal circumstances are much less favorable than when we consider the 2001 tax bill. We are in a different situation today, much different from that of 2001.

Today, we must keep the size of the tax bill within narrower limits. Today, we must be more concerned about contributing to higher interest rates. In that regard, I am pleased that the Chairman's mark keeps the bill within the $350 billion limit that was agreed to just a short time ago.

The second improvement, I believe, of how we could improve on the bill, is the President's proposal on dividends is troubling. It must be either eliminated or dramatically scaled down.

Yes, the tax treatment of dividends is a worthy subject, as part of a budget-neutral corporate tax reform debate. But the President's dividend proposal, at roughly $400 billion, is simply too fiscally irresponsible, too complicated, and affects too few taxpayers to be appropriately included in this stimulus package. It borders on irresponsibility.

Only 3 out of 10 tax filers report dividend income on

their tax returns. They are the only ones who would benefit from the dividend proposal. Seven out of 10 Montanans would see no tax benefit at all from a dividend tax cut and the consequence.

The provisions in this bill should benefit taxpayers more broadly across the income spectrum. That way, they can most effectively get money to taxpayers who would spend it and spur the economy.

The third improvement. I believe the President's proposal to accelerate tax cuts for those paying the very top rate poses difficulties. This proposal alone costs $35 billion. It would benefit only that 1 percent of American elite with incomes of greater than $311,000.

In better times, I would support a package that included benefits for those paying the top rate. But with the economy in the shape that it is in, now is not the time to accelerate this rate reduction. Once again, this provision is just too costly, too narrow, to effectively spur demand and rebuild the economy.

Fourth, more needs to be done to infuse funds to cash-strapped States and localities. The economic downturn has cut State and local revenues dramatically. But State constitutions, as opposed to the U.S. constitution, requires States to balance their budgets.

So State and local governments are forced to make

widespread, often painful, spending cuts in education, health, and other vital programs.

Even so, more than half the States are still struggling to balance their budgets in this fiscal year and next. These State spending cuts, I believe, more than offset any theoretical gains that tax breaks for the elite might pass on to others.

For example, last year the State of Montana cut benefits for severely mentally ill youth just in order to make ends meet. The State also made across-the-board cuts in Medicaid provider payments and increased cost sharing, both of which now threaten access to care for low-income Montanans.

If those cuts were not drastic enough, this year the State legislature just cut more than a quarter of a million dollars for Meals on Wheels for seniors. That will mean about 67,000 meals lost over the next two years. Budget constraints have also forced my State to put 700 working families on the waiting list for child care.

Translating Montana's small population to a national level, those cuts are the equivalent of more than two million lots meals nationwide and the equivalent of 22,000 families waiting for child care.

We can pass all the federal tax cuts we want, but

what good will they do if we force States and localities to raise taxes, cut jobs, and reduce benefits?

We can avoid these economically damaging State and local actions by assisting these governments with their budgets through the federal Medicaid match and other more broad-based methods.

Fifth, making tax cuts refundable will help spur economic growth. Very simple. It works. The child credit includes a significant refundable component. We should accelerate increased refundability so that the credit reaches more families. They will quickly get funds to people who are likely to spend them rapidly, spur demand, and rebuild the economy.

Sixth, we should decrease bonus depreciation deduction for the year that a business purchases new equipment. In 2001, we saw a sharp drop in direct investment by business. The next year, we changed the law to give a larger first-year deduction.

The drop in direct investment leveled, and even increased slightly. We need to improve more in the depreciation deduction for 2003 to encourage even more direct investment.

Seventh, we need to extend unemployment benefits and help those who have exhausted those benefits. The government reported Friday that nearly two million people

have been without work for 27 weeks or longer. The average time people have been unemployed is almost 20 weeks, the longest since 1984.

The weak economy has hit everyone, unfortunately, some more than others. As we rebuild the economy, we should not leave these unemployed workers and their families behind.

Any bill to help rebuild the economy must help those most affected by the bad economy. As well, putting funds in these hands will be an effective stimulus. The recipients of unemployed benefits, and their families, are likely to spend every dollar they get quickly. This spurs demand, which in turn helps rebuild the economy.

I make all these points with the recognition that our differences are not as large as what we have in common. We agree, broadly, that we need to create jobs and get the economy moving. We in this committee should take the steps needed to address those goals.

The economic times we face call us to govern. We should avoid political point-scoring. We must pass legislation to improve the lives of the people we represent.

Each of us was sent here by the people in our States. They sent us here, not to make speeches, not to win debates. They sent us here to make life better. In

these difficult times, they sent us here to help create jobs, to rebuild the economy. We have a duty to respond to the times, not the politics. We have a duty to do the people's work.

Thank you, Mr. Chairman.

The Chairman. Thank you, Senator Baucus.

I have the list that we usually get on a first-come, first-serve basis. So what I would do, is call on Senator Nickles, then Rockefeller, then Snowe, then Breaux, then Kyl, and Conrad. I will not go through the list now. But if Senator Daschle or Senator Frist comes, I ought to call on them next if they are under time constraints.

If anybody else has any time constraints, I would ask unanimous consent to go out of order. But if there is not that sort of consent, then I would stay by the order.

So, I would call on Senator Nickles.

OPENING STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM OKLAHOMA

Senator Nickles. Mr. Chairman, thank you very much. I compliment you for getting this to this stage. I am hopeful that we will be able to pass this bill today and pass a stimulus package, a growth package, a package that will create jobs next week in the Senate, and go to conference with the House and come up with a package that will truly help the economy.

The economy is soft. It needs some improvement. We need to create some jobs. Senator Baucus mentioned the fact that there are a lot of people who are unemployed. We need to change that.

In 1997, when we changed the tax on capital gains, I think we created a lot of jobs. This committee reduced the capital gains tax from 28 to 20 percent. It was very positive, very stimulative. It helped the economy, helped the stock market.

Well, we did not fix one of the errors in the present tax system, and that is the tax system on dividends. I am not satisfied with the mark that we have right now on dividends, I will be very frank.

Most of the provisions we have in the bill, I think, are good. But we did not do enough, in my opinion, to

eliminate the double taxation dividends. We tax dividends higher than any other country in the world. We tax dividends higher than France.

The mark that we have before us may be an improvement over present law, but it is not much. But this is the best we can do today. I am hopeful that we can do much better on the floor, and much better in conference. I just mention those.

I look at this economy and I think, we made changes in 1997 to help the economy, we can make some changes that would certainly help the stock market and help improve the environment for investment.

I used to run a manufacturing plant. It makes no sense to pay dividends right now. To pay corporate tax and to pay individual tax, tax rates that have an effective rate of 65 or 70 percent, is far too high. It is a real discouragement to distribute the proceeds or the profits of a company to the owners. The proposal that we have before us may be a step in the right direction, but it is a very small step.

So, again, Mr. Chairman, I may have an amendment on the committee to enhance this on the dividend side. I would hope that we would do it. If not today, I hope that we will do it on the floor. If not on the floor, I hope that we will do it in conference.

Again, I compliment you for bringing this mark. I know that you are trying to get the best package you can out of committee, and it is always a pleasure to work with you.

The Chairman. Thank you, Senator Nickles.

Now, to Senator Rockefeller.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM WEST VIRGINIA

Senator Rockefeller. Thank you, Mr. Chairman. I hope that we can have a productive session.

There are more than 8 million Americans that are out of work. There are more that are expecting to lose their jobs, and even those that have them, worry.

So, that is obviously the reason why we are into the business of trying to stimulate the economy, and the Congress needs to act on this and act in a way that we really helps, which does not just satisfy either side's ideological instincts, or whatever.

I think we also have to act promptly, but we have to act responsibly. It would not surprise the Chairman, for whom I have a great deal of respect, that the mark that you have presented is not exactly what I would have proposed.

But I am dedicated to working with you to try to see if we can come closer together. We have this day, and others, to do that. Making the economy grow is really important for us to do.

Now, I understand, Mr. Chairman, that your modification to this mark includes some State fiscal relief. As you know, I and several others have been

very, very active on this issue for some period of time. I am concerned that the amount of money in the mark for State fiscal relief is inadequate, given the desperate situation facing so many of our States.

I think we should all understand that anything we do to stimulate our economy on the federal level will be futile if we do not take the pressure off of the States, as Senator Baucus referred to, of cutting services and raising taxes.

In my own State of West Virginia, that has happened when the governor was forced to raise cigarette taxes, which is a difficult thing to do because we are surrounded by five other States, to get $60 million, and he put it all into Medicaid. It is nowhere near enough.

At the same time, just to pick an example, every public university and college in the State is being cut by 13 percent. You talk about un-stimulating the economy, that is a way to do it.

Now, 80 Senators, and three-quarters of the members of this committee, in fact, voted for State fiscal relief on the floor of the U.S. Senate, at least $30 billion in State aid, which was divided between half for FMAP for Medicaid, and the other half for Social Security's block grant. We voted, actually, twice. The year before we did the same thing on amendment, and got 75 votes at a

lesser amount.

Another essential amendment of any meaningful tax proposal, and my last point, is expansion of the child tax credit. There are 129,000 children in West Virginia alone whose parents or parent do not have enough income to qualify for the full child tax credit, made refundable.

It is very interesting, when you look at the statistics that qualify people and you see how people just do not make enough money to get along, and if they got that money, they would immediately spend it because that is what they have to do.

These are people who are exactly the ones that we should be targeting with tax relief to stimulate our economy. Any tax cut to these parents would immediately, as I indicated, be spent on food, housing, health care, education, and other basic needs.

So, I care very much about that, and several other subjects. I hope to work with my colleagues today because the worst thing that could happen would be to end up with a whole series of party line votes. I hope we do not do that.

Thank you, Mr. Chairman.

Senator Nickles. You can vote with us and make sure that does not happen. [Laughter].

The Chairman. Thank you, Senator Rockefeller.

Now, Senator Snowe.

OPENING STATEMENT OF HON. OLYMPIA J. SNOWE, A U.S. SENATOR FROM MAINE

Senator Snowe. Thank you, Mr. Chairman.

First of all, Mr. Chairman, I want to commend you for the collaborative manner in which you have engaged us in this process, and that has consistently characterized your efforts to reach a consensus, and most especially on this issue of such economic importance to our country.

No question, it has been a difficult process. I think it is no easy task to reach an agreement on an issue that has such economic magnitude to this country. Obviously, each of us on this committee certainly would craft a different proposal. But I think, ultimately, Mr. Chairman, you have worked through tirelessly to reconcile the disparate views as to how we can actually achieve the goal of economic growth.

I happen to believe that we are achieving a sound and fiscally responsible agreement that will satisfy the dual critical challenges of both stimulating the economy, while at the same time exercising fiscal restraint without unnecessarily driving up unsustainable federal budget deficits in the future.

The President's adamancy on job creation is central to rejuvenating the economy. The President is correct

that we should promptly pass a robust economic growth plan, because the risk of doing nothing and incurring a jobless recovery is a risk that we do not want to take in this country, particularly when we consider that job creation is going to be absolutely vital in stemming the losses of jobs throughout this country when we are an eight-year high when it comes to unemployment. We have lost 2.3 million jobs since March of 2001. So, it is absolutely imperative that we design a growth plan that focuses on job creation.

The result before us today is a sound policy, consistent with many of the principles that I established at the outset of this process. The only measures that are providing short-term stimulus should be included in a deficit finance package, and initiatives that spur long-term economic growth should require offsets.

The $350 billion in tax cuts contained in the package before us today will provide for all of the stimulative proposals that have been recommended by the President in their entirety.

As one economist indicated recently, within that figure we will likely get most of the short-term job boost. Three hundred and fifty billion dollars is by no means an inconsequential tax cut. It well may be the third largest tax cut ever.

The largest in history, of course, was in 2001, and many of those initiatives are being accelerated in a program before us today, both to boost consumer purchasing power by accelerating the child tax credit and eliminating the marriage penalty.

It also encourages business investment, with tripling of small business expensing, a right move to spur job creation immediately because small businesses represent 75 of the net new jobs created in this country, representing more than half of private sector output. So, rightfully, it focuses on small business initiatives.

State and fiscal relief. I view that as another important, significant dimension to economic stimulus. With States facing a combined shortfall of more than $68 billion in this coming fiscal year, I think the Chairman was right on the mark to including a trust fund in the package of $20 billion to provide assistance for the States to be used for the purposes of Medicaid, transportation, homeland security, education, and other critical functions.

I know this is an issue that is important to my colleague from Maine, Senator Collins, Senator Smith, as well as Senator Rockefeller, and I know we will continue to work on this issue.

At the same time, we also have established what I

think is a responsible policy on the taxation of dividends as a foundation to build on as we assess the reaction of, and the overall impact on, the financial and business sectors and how the capital markets would react.

I know, in listening to my colleague, the Senator from Oklahoma, about his strong views, and I know those are the views held by others on this side of the political aisle, and obviously the President, but this is a way in which I think we can build on that foundation for the future.

It is consistent with Chairman Greenspan's approach, which has said that dividend taxation and the elimination of that would bolster the economy's long-term ability to grow, but that we should also be revenue neutral.

So we do provide bona fide offsets to the $80 billion costs in this legislation. With the agreement, as the Chairman has indicated, it will be the first $500 of dividend income that would be tax-free. That would benefit 84 percent of those who file federal income taxes.

We also provide an additional tax-free of 10 percent in the first five years, and 20 percent in the last five years of this package. I know some groups have already expressed disagreement with offsets, but the fact of the matter is, we can ill afford to create deficits in

perpetuity.

We are now in a new realm of fiscal reality that has been brought upon us by the myriad challenges, both domestically and internationally--as the President said, they all have arrived in a single season--as well as the pressing domestic issues that are looming on the horizon.

We cannot ignore the unending deficits that will undermine our strength and our ability to address vital programs, such as Social Security, as well as Medicare.

This decade was supposed to be our window of opportunity. Because of the $5.6 trillion surpluses that we enjoyed just two short years ago have now evaporated, and we know the reasons why, because of the downturn in the economy, because of Iraq, because of homeland security, because of the war on terrorism.

But now we are facing deficits as far as the eye can see. Projected deficits this year alone can be upwards of 54 percent higher than last year. It could be as high as $500 billion. That could be the highest deficit ever, the true cumulative deficit of more than $4 trillion over this next decade, including $2 trillion for the Social Security trust funds.

Well, that is why, Mr. Chairman, I think it is important that we cannot ignore the corrosive effects of deficits that will affect our long-term viability of this

economy.

As Chairman Greenspan indicated recently, the deficit does affect long-term interest rates, it does have an impact on the economy, and he also warned, if you get significant increases in deficits which induce a rise in long-term interest rates, you will be significantly under-cutting the benefits of tax cuts.

So I think that this legislation before us today enjoins those two issues in a fiscally responsible approach by providing a growth plan that lays a foundation for stimulating the economy and creating new jobs, while at the same time providing a basis for sensible, long-term tax reform without unnecessarily ballooning future federal deficits.

So, Mr. Chairman, I want to commend you once again for trying to achieve a consensus, both in a sensible and a responsible way.

The Chairman. Thank you, Senator Snowe.

Would Senator Daschle like to proceed now? Because I am calling according to first arrival. But I announced that, for floor leaders, we would go out of turn.

Would you like to go now?

Senator Daschle. Mr. Chairman, thank you very much. I would appreciate that.

The Chairman. Senator Daschle, please proceed.

OPENING STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator Daschle. I thank the Chairman for his kindness and his courtesy.

Just over two years ago, America's economy was shattering records of economic growth and prosperity. Today, America's economy is setting very different records. We are in the longest period of job losses since the Great Depression. In the last three months, our economy has lost another half million jobs.

Eight and a half million Americans are out of work today. One in five of those workers has been out of work now for more than six months. Economists and employers warn that we may not have hit the bottom yet.

But it does not have to be that way. America has the best educated, best trained and most innovative workers in the world. In South Dakota and across America, people are eager to work hard to turn their good ideas into good jobs.

The American people need, and deserve, an economic plan that works for them, not against them. That is the kind of plan that the Democratic Caucus has offered. Our economic plan will create jobs now and restore opportunity and prosperity for all Americans without

mortgaging America's future.

The President has suggested that the test for economic plans should be which plan creates the most jobs. Well, our plan wins that test two to one. According to the respected economic forecasting organization Economy.com, our plan will create 1.2 million jobs by 2004, twice as many as the Republican plan.

The Democratic plan also cuts taxes for every working American. The centerpiece of our plan is tax cuts for middle class families in the form of a wage credit. It will provide $300 for each adult and $300 for each of the first two children.

We also increased the child tax credit and speed up the reduction of the marriage penalty. These cuts will save a family of four making $50,000 $16,030 on their taxes this year. That is about $500 more than the family would receive under the bill before the committee today.

Our plan will also help small businesses, with a 50 percent tax credit to help employers maintain health coverage for their workers. It provides large and small companies with tax incentives to invest and create jobs also this year.

Our plan extends unemployment benefits for nearly four million laid-off workers, not just because it is the

decent thing to do, but because it is also the fastest way to jump-start a stalled economy.

Our plan provides $40 billion in immediate assistance for State and local governments to help them avoid raising property taxes and cutting school and public safety budgets, and other vital services.

Our plan is fair, fast-acting, and fiscally responsible. It provides three times more economic boost this year when we need it the most than the Republican plan, at a fraction of the cost.

It does not create huge, permanent, new obligations that will damage our economy in the long run and burden our children and grandchildren with additional debt. Regrettably, the administration plan, which is now reflected in the Chairman's mark, would take a very different direction.

I say with great respect for the distinguished Chair of our committee, my friend Senator Grassley, he has been struggling mightily to accommodate a broad range of views in the Caucus. He is in a very difficult position and I commend him for working so diligently and in such good faith to get something done.

But, having said that, the bill before us would not improve our economic outlook, but rather worsen it considerably. It would create far fewer jobs now when we

need them. It will discourage job creation in the future. It weakens Social Security by spending those funds on more tax breaks for the elite. In so doing, it slights middle class families in favor of those elite few.

It will drive up property taxes and cause cuts in vital services to the States. By giving rise to massive deficits, it will drive up interest rates, making it more expensive for families to buy a house, pay for college, or cope with credit card bills.

So we have a clear choice before us: more jobs or more debt, a stronger economy or a weaker one. Two years ago, America tried the approach advocated by the administration and it simply has not worked.

So, again, the choice is simple: pass a Democratic jobs opportunity and prosperity plan and create 1.2 million new jobs, or pass the Republican plan and prepare for growing deficits, higher interest rates, and more of the same economic conditions we have today.

I hope this committee will make the right choice. Again, I thank the Chair for his courtesy in extending me this time.

The Chairman. And I thank Senator Daschle.

I would then go, now, to Senator Breaux, then it will be Senator Kyl.

Senator Breaux?

OPENING STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM LOUISIANA

Senator Breaux. Thank you very much, Mr. Chairman. Congratulations on apparently putting together a package that will gain majority votes to present this bill to the Senate floor. It is not a bill that I feel comfortable with. I think we could have done much better than this package presents to the full Senate floor.

It is unfortunate, really, that we have spent so much time talking about the differences between the two different perspectives on what we should do, because both sides have a great deal of commonality about what we were trying to do which we did not focus on.

I mean, both sides, for instance, talked in terms of bringing rate cuts forward. Both sides had provisions of the marriage penalty. Both sides had increases in the child tax deduction. Both sides had expensing increases for businesses under Section 179. Both sides had some AMT relief.

But it really broke down as to whether we were going to use the limited amount of money we had in order to provide dividend tax relief for a few number of Americans.

I think many of us felt that that was not very

stimulative in the short-term. It is probably good tax policy in the long term, but as Alan Greenspan said, it is not going to have a big effect in the short term on the creation of jobs.

And it should be paid for. Tax cuts are fun to do. It is great to cut taxes. But it is not free. We have got to find a way to pay for them.

The offsets we have in this bill have already been used. How many times can an offset be an offset? I mean, these offsets are as rare as a fat chicken running around in Baghdad. I mean, you just pick them up, grab them, and run with them as fast you can, but they have already been used.

They have been used in the energy bill, they have been used in the CARE bill. Now they are going to be used again in the tax bill. I mean, you cannot use them more than once, and we have been using them three and four times.

So, we are borrowing the money to do a tax cut. If we are going to do that, which I think we could do in a limited amount of money, we ought to be careful in how we do it.

On the dividend tax cut, which I do not think is stimulative, 92 percent of the people in the State that I represent are not affected by it. They do not pay it.

Either they do not get dividends, or the ones who do put it in a retirement account, which is already tax deductible.

So, originally the administration was trying to spend $400 billion over half of the whole tax package to provide tax cuts for something most people are not affected by.

The theory goes, well, let us see. If we give corporations and eliminate tax on dividends for individuals, they will buy more stock in the company. If they do that, then we hope the company does not pay their executives more with the extra money, or we hope they do not use it to buy down debt, or we hope they just do not save it for other future projects. We hope they go out and hire more people.

Well, we hope, we hope, we hope. I do not know why they are going to be going out and hiring more people if there is not enough demand to require them to hire another person to produce a product that nobody is buying.

I mean, there are a lot of questionable, questionable, legitimate questions about the reality of what a dividend tax cut can do, and people much smarter than I have questioned the wisdom of it. I think that by reducing the amount, well, that is better than having the

whole amount.

We are spending an awful lot of money that we are borrowing for something which I think is very, very questionable as far as its effectiveness is concerned.

Then I noticed one of the things we are doing on the dividend tax cut, somehow, if you are an American citizen, invested in Shell, British Petroleum, or a foreign company that does business in this country, somehow you do not get the dividend tax break.

I mean, you are going to tell me that U.S. citizens in my State that buy stock in Shell, or British Petroleum, or Daimler-Chrysler, or any of the over 200 foreign companies that locate in Louisiana and employ Louisiana citizens, that somehow this bill is going to say, however, if you buy stock in that company, you are not going to get the dividend tax break that this bill provides?

What kind of policy is that? These companies work here in this country. They hire Louisiana and U.S. citizens. They pay State taxes in this country. But if you get a dividend from them, you are not going to be treated as if you get a dividend from any other corporation doing business in the United States? That is not good tax policy. It is sort of vindictive tax policy, and I do not think we should moving in that

direction.

So, anyway, I think we are not finished with the bill. It is a long ways before completion. This is the beginning, not the end. Hopefully we will have an opportunity to reach an agreement that can be truly bipartisan and that the President can sign.

Thank you.

The Chairman. Before I call on Senator Kyl, I would take 30 seconds to comment on the last point about foreign stockholders, or stockholders of foreign corporations. I want to assure you that we discovered that late last night.

We wanted to take care of it, we just did not have time to take care of it in a proper way. I would like to work with you on doing that. I am not sure exactly how we are going to do it yet, but we would like to do that. We think we might have some money reserved to accomplish that. I am not sure, though, at this point.

Senator Kyl?

OPENING STATEMENT OF HON. JON KYL, A U.S. SENATOR FROM ARIZONA

Senator Kyl. Thank you, Mr. Chairman.

I support the President's plan as the best way to provide new jobs and economic growth. I reluctantly will support the Chairman's mark as a way to keep the bill alive and allow the full Senate to work its will, but I do not endorse all of its provisions.

We must not further amend the bill in ways that would undermine the economic growth goals of the President, and I am very hopeful that the bill that we eventually send to the President will adhere more closely to his proposals.

The Chairman. Thank you, Senator Kyl.

Now, Senator Conrad.

OPENING STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator Conrad. Thank you, Mr. Chairman.

Let me, first, commend you. This is a difficult job. I especially appreciate the way you have conducted the business of this committee and your willingness to reach out to all of us for our ideas.

Unfortunately, we were not able to agree at the conclusion, but I do appreciate very much the way you have conducted the Chairmanship of this committee. We could not have asked for more fair treatment and more inclusiveness in terms of reaching out to members of the committee.

Let me follow that by saying I profoundly disagree with this package. I profoundly disagree with the direction that we are taking in the fiscal affairs of this country.

I believe this package is ineffective as a stimulus. I believe it is irresponsible in terms of the fiscal affairs of the Nation, and I believe it is unfair in that it is heavily weighted to the wealthiest among us.

First of all, I believe Congress is now increasingly disconnected from reality as we approach the most important fiscal decisions for the country's future. The

tax cuts that are being discussed here are not $350 billion, or $550 billion, as the media has reported over and over and over.

The tax cuts that are authorized in this budget are $1.3 trillion. That is what is authorized in the Senate, that is what is authorized in the House, $1.3 trillion of tax cuts. That, in the context of massive federal budget deficits.

The deficit this year is now estimated, on an operating basis, to be between $500 and $600 billion. That is the largest budget deficit we have ever had. In fact, we do not see the deficits below $300 billion in an operating basis the rest of this decade.

Senator Baucus. Might I ask, over what period is that?

Senator Conrad. Ten years. Now we see the latest news from the Treasury Department, which I would share with my colleagues. These are numbers just in. Revenue this year, in the first seven months, is running $100 billion below the forecast. If this trend continues the rest of the year, revenue as a percentage of our gross domestic product will be the lowest since 1959.

You will recall two years ago, when revenue was at 20.8 percent, which was the highest it had been in 40 years, the President said we have got to cut taxes

because revenue is too high as a percentage of gross domestic product.

Now, when we are headed for the lowest level of revenue as a percentage of our gross domestic product, he says, cut taxes again. I do not think this is a consistent approach or one that can withstand much scrutiny.

Chairman Greenspan has warned us that these large additional tax cuts will drive us deeper into deficit, and that the dead weight of those deficits and debt will actually hurt our long-term economic growth.

I do not believe this is an economic growth package. I believe this is a package that will hurt long-term economic growth. Why? Because it is exploding deficits and debt.

That additional deficit, that additional debt, will reduce the pool of societal savings. That will reduce the money available for investment, and you have got to have investment to grow.

Next, I think this plan is ineffective with respect to stimulus. If we look at the three plans before us, we can see that Senator Daschle's plan has much more stimulus in this first year, $125 billion, than the plan before us which has only $46 billion of stimulus in this year. The House plan is $48 billion of stimulus this

year. It makes no earthly sense to me. The economy is weak now. This is when we ought to be giving it a boost.

Senator Daschle's plan gives about three times as much lift to the economy now as does the plan before us, yet it does it without the dramatic increase to deficit that is contained in this plan and the House plan.

Let me just go the next slide on why I believe this is such as serious moment for us. This looks at the Social Security trust fund, the Medicare trust fund, and the tax cuts. The blue part of the bar, the Medicare trust fund, the green, the Social Security trust fund, the red are the tax cuts.

What it shows us very clearly, is the tax cut cost explodes at the very time the cost to the Federal Government of the retirement of the baby boom generation explodes, leaving us with utterly unsustainable deficits and debt. This is not just irresponsible, in my judgment. It is profoundly irresponsible.

Finally, I would say to my colleagues, I believe the tax cut packages that we have before us are unfair. They are unfair because the distribution is heavily weighted to the wealthiest among us.

Let me just say, I am looking at the President's package and the House package because we do not yet have a score of the Chairman's package that is before us. But

the President's package would give, to the middle 20 percent of taxpayers, on average, $227 of benefit; to those with incomes of over a million dollars, it would give a benefit of $89,509 in one year.

The House package is even more skewed to the wealthiest among us, giving the middle 20 percent of taxpayers a benefit of $217 on average, giving taxpayers with income of over a million dollars a tax reduction of over $93,000 in 2003 alone.

So, for those reasons, Mr. Chairman, I believe this plan is ineffective as stimulus, irresponsible in terms of fiscal policy, and ultimately unfair in the distribution of its benefits.

The Chairman. Senator Conrad, thank you very much.

Now, Senator Thomas.

OPENING STATEMENT OF HON. CRAIG THOMAS, A U.S. SENATOR FROM WYOMING

Senator Thomas. Well, thank you, Mr. Chairman. I will be short.

I had hoped that we had come here to get on with the business and make some decisions, and I hope I will be short so we can get there.

We have heard most of these comments before. We have seen the charts. But I do thank you for putting together a plan that we can move forward. That is the bottom line, is doing something.

I hope that we focus on the real purpose for our being here, and that is to stimulate the economy, to create jobs, to strengthen the economy. I think you will find that the reason revenue is low is because the economy is not doing well. That is why we are here.

So, I intend to support the Chairman's mark, although I have some changes I would like to see. It is not exactly the way. But we need to get it out of this committee and we need to get it on the floor. We need to get it finished and get it to the President so that we can have something done about this economy.

Thank you, Mr. Chairman, for what you have done. I look forward to moving forward.

The Chairman. Thank you, Senator Thomas.

Now, to Senator Graham of Florida.

OPENING STATEMENT OF HON. BOB GRAHAM, A U.S. SENATOR FROM FLORIDA

Senator Graham. Thank you, Mr. Chairman. We all appreciate your efforts to craft a bill that hopefully at some point will be able to achieve bipartisan support, because we all share in common the agreement that this economy needs a stimulus. The facts are startling to incredible, what has happened to the American economy in barely two years.

We have lost over two million jobs, much of that loss in the last 100 days. The stock market has lost 25 percent in value, carrying with it the pension and retirement aspirations of many Americans.

The economy's growth rate in the last quarter was an anemic 1.6 percent, and consumer confidence in the last 27 months has dropped by 34 points.

Clearly, we need a plan to stimulate the economy, but that is not our only challenge. We also are facing an enormous demand on the Federal Government when the large number of persons born after World War II reach retirement age.

We had had a policy under way in the 1990s to prepare for that by reducing the national debt, by virtually eliminating the national debt owed to the public. That

was when we had surpluses of over $5 trillion over the next 10 years.

Unfortunately, in barely two years, we have completely squandered the surpluses and we are now looking at additional national debt of over $2 trillion in the same 10-year period.

So, that is one problem, is the issue of how to prepare for the enormous cost that the Federal Government will be facing when this large group of Americans reaches retirement age.

Second, State and local governments are in the deepest distress in a 50-year period. As such, they are cutting back on programs that are a critical part of the safety net for Americans. They are also about to release thousands of employees who will add to that two million unemployed Americans.

Finally, we have the problem of those who already were unemployed. Last month, we hit 6 percent unemployment, many of those long-term unemployed, so many that we are now reducing the number of people who are considered in the job market, because people have lost hope that they will find a job.

Now, how do we attack all these problems? First, I think we would do it by a candid diagnosis of what our problem is. The President's plan essentially says that

our problem is that we do not have enough saving and investment to create job stimulation. I disagree with that analysis.

This picture is a few of the 300 modern airliners which are parked on a desert in Arizona. Those airplanes are not parked in the desert because Boeing cannot build more airplanes. Those planes are parked in the desert because there are not enough passengers to fly in the airplane.

So if we are going to have a reasonable economic stimulus, in my judgment it has to focus on creating more demand, not creating more supply. To do so, these are some principles that we should follow.

Any stimulus expenditure should be in the next 24 months. The President's plan is egregiously inefficient, with almost 80 percent of his cost being after the two-year window in which we should be focused on having an impact.

Second, the focus should be on those Americans most likely to spend, which are workers and small business, and thus to create the demand that we need to begin to roll some of these airliners out of the desert into useful service.

We must provide some aid to the States. Now, some would say, why should we be doing this? That is the

States' responsibility. The fact is, much of the States' fiscal problem is of our creation.

We have passed legislation in homeland security and education, for instance, created new demands on State and local governments, and not provided the resources to pay for it as we had promised to do.

We have also undermined State tax revenue by things like accelerating the estate tax repeal for the States, while we were allowing the repeal for the Federal Government to run for a substantially longer period.

Finally, we should reject any additions to the national debt. That is, all of this tax-derived economic stimulus should be paid for. The failure to do so is to create a time bomb for our Nation's economic future as we cause more and more debt to be in competition with the necessary borrowing for businesses and investment purposes, as we put pressure upward on interest rates, making everything from people's mortgages to the cost of buying an automobile more expensive.

I will be offering later today an amendment which incorporates those principles of a stimulus which is paid for and which provides assistance to the States. I hope that my colleagues will be open-minded and receptive to these principles and the ideas of how to implement them.

The Chairman. Thank you, Senator Graham.

The next person, in order of arrival, is Senator Santorum.

OPENING STATEMENT OF HON. RICK SANTORUM, A U.S. SENATOR FROM PENNSYLVANIA

Senator Santorum. Thank you, Mr. Chairman. I, too, want to congratulate you on the difficult job that you had in pulling this together. But, as always, you have done so with a great amount of skill and you are to be congratulated for your effort.

Just a few comments about what has been said here this morning. First off, the President's plan is really focused on dealing with the economic slow-down and the causes of this particular economic slow-down. .

I think some of the comments that have been made about the need to increase consumer spending and get the consumer out spending more, which has generally been the reason for economic slow-downs in the past, I think, has been pretty well laid out, that it was not the reason for this economic recession. This is not the reason for the rather slow recovery that we are seeing.

Consumer spending, really, I think for the first time in any history of a recession, actually did not go down, or go down into a negative area. What we saw, was continuing growth in consumer spending.

But the problem has been on the business side, and particularly influenced dramatically by the stock market,

the dramatic decline in the market and the impact that has had on businesses willing to take risks and to grow their companies.

So, what the President has done is tactically put forward a plan that deals with incentivizing businesses to grow and to support the market, and increase the valuations of the market, as well as change corporate behavior, and other long-term benefits of the elimination of the double taxation of dividends.

So the President's plan really does address the problem where it is. I know these are not necessarily the most popular things, because they do not affect as many people, as the Chairman noted earlier. You cannot look at how we solve this problem just by looking at how many people are affected. You have to look at, does it solve the problem in our economy.

I would make the argument that the President has, with a surgical strike, addressed the issues that are affecting our economy, resulting in slower rates of growth than are desirable and higher rates of unemployment than we would like to see.

So, the President has put forward a very responsible package. His package was $726 billion over 10 years. This package, in which we hope to put as much economic wallop as we possibly can by the time we are done, I

believe we can do so within a smaller framework. We need to do so in addressing the issues that are the problems with the economy, not necessarily what is politically popular.

On the other side, I just want to remind people who have been talking about the concern for deficits and the concern for fiscal responsibility, that there was a half a trillion dollars in spending add-ons proposed by the other side of the aisle on the appropriations bills in January, and $1.6 trillion in additional spending, all of which would have been added to the deficit over the next 10 years that were proposed by the other side of the aisle on the budget.

So if there is this great concern for fiscal responsibility, then why the willingness to spend hundreds of billions and trillions of dollars in additional spending here in Washington, and the reluctance to give a paltry couple of hundred billion dollars over the next 10 years in tax relief to stimulate the lagging sectors of our economy?

This is about creating jobs. This is about a tactical and strategic approach, to do it in a way that addresses the problems that are before us.

One final comment. I would just say that the most important thing that the Chairman has tried to achieve in

the past on this committee is trying to put forward a bipartisan bill. I know he worked very diligently on doing so.

We had a meeting just a few days ago, and many on the other side were calling for another bipartisan bill. My response to that was, I always thought working on bipartisan bills is that once side of the aisle would come forward with the top two or three things that were most important to them and the other side of the aisle would come forward with the top two or three things that were most important to them, and you sat down and you worked with that to come up with, truly, a bipartisan bill.

One of my colleagues on the other side of the aisle said, well, the problem with that is, our top one and two priorities is to stop your number one and two top priorities. That makes it very, very difficult to find comity when the other side's chief objective is to block what you want to accomplish.

So, it really has made it a very difficult challenge, a virtually impossible challenge, for the Chairman to put forward a bipartisan bill. So, what he has done, I think, is clearly quite remarkable under the circumstances, and he is to be congratulated.

The Chairman. Thank you, Senator Santorum.

Now, according to arrival, Senator Bingaman.

OPENING STATEMENT OF HON. JEFF BINGAMAN, A U.S. SENATOR FROM NEW MEXICO

Senator Bingaman. Thank you very much, Mr. Chairman.

There are obviously elements in the package that you have presented to the committee that I would support and that are consistent with provisions that are also in the proposal Senator Daschle is going to offer later this morning, as I understand it.

But, on balance, obviously, I am not able to support the package that you are presenting. In my view, it does, when stripped of all of the niceties, essentially propose to borrow another $350 billion, add that to the debt, add that to the deficit, and do so in order to grant a very substantial tax cut.

The Senator from Maine, I think, put it well by saying this is the third largest tax cut in the history of the country. We adopted the largest tax cut in the history of the country in this committee two years ago and in this Senate two years ago. Obviously, our fiscal situation has worsened dramatically.

In my view, it is not responsible to go ahead with another large tax cut, particularly when a substantial amount of that does not really add to any stimulus in any

meaningful way here over the next year or two.

Another problem which has been pointed out by several Senators here, which I agree with, is that this clearly is moving us in the direction of lower, and eventually no, taxes, perhaps, on investment income, while more and more the tax burden gets shifted to people who have to work for a living.

I think that is not a good direction for us to be going in this country. The push seems to be constantly, let us reduce the tax on investment income, in this case dividend income, but I think that is a wrong-headed view of how we should proceed.

So, on balance, I am not able to support the package that you are presenting. I do believe it is under the guise of trying to stimulate the economy. I think what the package winds up doing is locking into place a substantial tax reduction at a time when we cannot afford it, and I think that is not wise public policy.

The Chairman. Thank you, Senator Bingaman.

Now, the next person on the list is Senator Lincoln, and then Senator Bunning, then Senator Smith, and if Senator Lott is here, he would be next, and then, I think, Senator Jeffords.

Senator Lincoln?

OPENING STATEMENT OF HON. BLANCHE L. LINCOLN, A U.S. SENATOR FROM ARKANSAS

Senator Lincoln. Thank you, Mr. Chairman.

I, too, want to thank you for your outreach to all of us as members to work with us. You have always done that and it has certainly made serving on this committee a real delight, because you do reach out in a very genuine way, I think, to try to work with each and every one of us. We are all appreciate of that.

I have said before that I do not disagree with the intent of what President Bush and others are trying to do in a stimulus plan. I do think that our economy deserves, and should be stimulated at a time like this.

However, I do have some concerns about how we do that. I think it is most appropriate for us to look at ways that we can complement what needs to be done in industry and business in terms of growing the economy.

But we also have to know that when our industries are operating at only 70 percent, that the assurance that those that are going to stimulate the growth through consumption have got to have the ability to do that.

We have got to look at the working families and their needs, those that have been working that are no longer working, those that are, as many have put, in a great way

excited and wanting to work, but not having the opportunity.

We have to look at what our families are going through. When you look at a State like Arkansas and you recognize that we have got 80 percent of our 2.6 million people who have an adjusted gross income of under $50,000, these are working families where a child credit is absolutely essential if they are going to stimulate the economy through their consumption and demand of what these companies want to provide in the increase from that 70 percent capacity of production.

So, I think, Mr. Chairman, as you have put together a lot of good components in this package, I agree with some of my other colleagues that I wish we had worked a little bit harder at getting some of the components that I think could do a whole lot more in terms of stimulating the economy.

When we look at that child credit, the refundability of it is absolutely essential for those working individuals who are trying, heart and soul, to keep their families together, to pay for the things that these growing children and these growing families need. But the fact is, if they do not have that amount of income to credit it against, they are not going to benefit.

I mean, these are families that are desperately

trying to make it. I firmly believe, Mr. Chairman, that if what we want to do is stimulate this economy, there is no greater way than to support the working families that make up this great country.

These are the people who are going to help us grow the economy. Without a doubt, we know that the industries that are out there, the businesses, that certainly need the assistance to be able to jump start the economy, we know that the engines of the economy in this great country are not the government.

We are not the engine. It is the corporations, the businesses that create the jobs that give these families reason to be proud. It takes a balance to do that.

It takes a balance in terms of looking at our Tax Code and providing the incentive for both of those, both our industries as well as our corporate America that can reinvest, but also our families, our small businesses, who in Arkansas are our largest employers.

These small businesses need the ability to be able to reinvest that capital in themselves. They grow those sustainable jobs. They grow those sustainable jobs that stay right in our States and in our communities, not that we have to debate whether or not they are going to get shipped offshore or anywhere else.

So, Mr. Chairman, I hope that as we work through this

mark-up we will look for the ways that we honestly can improve this bill, not fight over who is going to win, or who is going to lose, but remember that at the end of this day the objective of this committee is to support the working families of this country and to help the good corporate citizens of our country to help us grow this economy.

I, for one--maybe I am an eternal optimist--believe we can do it. With the man and woman power we have in this committee, I think we can look at the plausible, balanced approach that is going to achieve that objective, and I thank the Chairman for his leadership. I hope that we can come to that very conclusion.

Thank you.

Senator Bunning. I believe I am next, if the Chairman is not here.

Senator Baucus. Yes, you are next.

Senator Bunning?

Senator Bunning. Thanks, Max.

OPENING STATEMENT OF HON. JIM BUNNING, A U.S. SENATOR FROM KENTUCKY

Senator Bunning. Mr. Chairman, today we are faced with the difficult, yet critical, task of composing a tax bill that will get millions of Americans back to work. It is time to put politics aside and produce an economic stimulus package that will lower our unemployment rate by putting more people to work, and putting to work quickly.

I have spoken to many Kentuckians who have either lost their job, or know a friend or relative that is one of the more than half a million Americans that have lost their job over the last three months.

Those workers are why we are here. They are why the President made the strong proposal that he did. Put simply, investment drives growth and growth creates jobs. The economic stimulus plan before us today should focus on immediate tax relief for individuals and incentives for business to invest and grow. That relief must be quick and it must be meaningful.

Many on the other side of the aisle have talked about Alan Greenspan. Well, I happen to be on the Banking Committee also, and he testified in 2000 about how the wealth effect was destroying our economy and how it was going to throw it out of kilter if we did not do

something about the wealth effect.

Well, Mr. Greenspan did something about the wealth effect. He continued to raise interest rates until June of that year, and then waited until January, in an emergency meeting, before he started reducing interest rates.

The country was already in a recession in October, and continued to plummet into what I call the Greenspan Recession. His interest rates went up too fast and he failed to recognize it and failed to cut them in time to save us from a recession.

Many on this panel have serious concerns about budget deficits. None of us like deficits. But without significant tax relief, we will not have an economic growth. It is economic growth that is the quickest avenue to restoring a balanced budget.

We must focus on the big picture, please. An effective stimulus package will encourage growth in the economy, more Americans will find work, and tax revenues will actually rise.

We should learn from the lessons of the Kennedy tax cuts in the 1960s, and the Reagan tax cuts in the 1980s, and move forward toward greater prosperity. We cannot afford to wait any longer.

The Chairman's modified bill before us is not the

bill I would have considered if I had my way. I would like to be providing more tax relief to the American taxpayers and American business than is found in this bill, and I would like to be providing it this year.

The American economy is not growing as it should, and we should be giving it a shot in the arm. We should provide larger tax relief, and provide it sooner rather than later.

This bill is less, much less, than we should accept. It is less than the tax relief that the American taxpayers deserve and that this economy needs.

However, I will support this bill in committee with the hope that it can be improved, substantially improved, on the floor of the Senate.

Thank you, Mr. Chairman.

The Chairman. Thank you, Senator Bunning.

The next person is Senator Smith.

OPENING STATEMENT OF HON. GORDON SMITH, A U.S. SENATOR FROM OREGON

Senator Smith. Thank you, Mr. Chairman.

In my first term in the U.S. Senate, I was privileged to serve on the Budget Committee. I saw many of my friend from North Dakota's charts over those long years.

I have to tell you why my friend's charts are so hard for me to take. That is simply that, as deficits are decried and doom is predicted, far more spending is proposed right afterwards than there is tax relief offered to the American people.

Senator Bunning just said it well. Investments create jobs, which create growth. We do not centrally plan our economy, and may we never do that. Much has been said this morning about a squandered surplus. What is forgotten when that is said, is that our economy in the late 1990s was based on a stock market bubble. That bubble popped.

Alan Greenspan called it "irrational exuberance." I believe that was why he was raising interest rates. But it was that irrational exuberance that churned cash in our system and created resources that frankly were never real.

The stock market crash that President Bush inherited

was followed by 9/11 and a war on terrorism to keep the American people safe.

I shudder to think where our economy would be now if we had not cut taxes in 2001. I am glad we did that, because we are better off than we otherwise would have been.

Well, I think what the President has proposed is a fix of a fundamental flaw in our capital markets. That is the elimination of a double taxation on dividends. I believe that will restore us, or help to restore us, to rational exuberance.

Back to some fundamentals. We actually had serious people in this country, economists, trying to tell us that you could separate stock values from book values. But, frankly, we did it to an extent where we have suffered a collapse.

Well, some people call this trickle down economics. We focus on Wall Street. The point is, if you help fix the fundamentals on Wall Street, it will get to Main Street and it will get to your street.

The real debate that is going on here for the American people watching is whether you can spend the money better than we can spend the money. I learned in the most basic economics course that a multiplier effect of a dollar left in your home, in your community, will

turn over four times. If you bring it to Washington, DC, it may turn over in your community once, maybe.

So if the goal here is a family wage job and a future, then for heaven's sake, let us understand where wealth is created. It is created at home. It is not created right here.

So, as you hear all these decrying of squandering the surplus, let us remember what makes our economy go. It is not government spending, tax and spend, grow government to solve everybody's problems. It is about investment, it is about freedom, it is about creating jobs that result in growth and opportunity for people.

Now, there is one piece of spending I am supporting, Mr. Chairman, because I think it is important. I think Senator Graham was right. A lot of the problems with our States are due to their profligacy, some of it, but much of it is driven by federal mandates.

It is my understanding, Mr. Chairman, that in your mark there is $20 billion that will be available to the States. There is a placeholder so that we can bring this up on the floor.

That is why, out of respect for you, I am willing to do this on the floor to the extent that we can hit $20 billion, $10 billion of which can be used by the States for FMAP.

I will tell you why we need to do that. I think we need to do that so we can help our States because of the problems we have imposed on them through unfunded mandates. I believe we need to be concerned about the ranks of the uninsured that are growing. It is a way that we can better meet our federal responsibility of the States.

I know Senator Rockefeller will offer some amendments. I am going to keep my commitment to you to do this on the floor. I believe our side is united on this. Frankly, it is important for this to happen on the floor for me to vote for final passage.

Mr. Chairman, I think it is important to note the work of Senator Collins and Senator Ben Nelson, who worked with Senator Rockefeller and me on this proposal of $20 billion. That is the limit, not a penny more, not a penny less. That is what we need to do.

Ten of it ought to be for FMAP. That will help the States, it will help us keep faith with them, and I hope it will help them not to raise taxes so that they are offsetting what we are proposing to do.

Thank you, Mr. Chairman.

The Chairman. I think I have said before, but I will say again, that I do intend to show leadership in that area of aid to the States.

Also, along that line I did get a letter faxed to us about what we did yesterday from the National Conference of State Legislatures, Council of State Governments, National Association of Counties, U.S. Conference of Mayors, National League of Cities, and the International City and County Management Association.

Just the first paragraph says, "On behalf of State and local officials, we appreciate and support your proposal to provide $20 billion in fiscal assistance to State and local governments in reconciliation pending before your committee."

Now I would turn to Senator Jeffords.

OPENING STATEMENT OF HON. JAMES M. JEFFORDS, A U.S. SENATOR FROM VERMONT

Senator Jeffords. Mr. Chairman, like everyone else here today, I would like to do something to give a jolt to the economy. None of us here in Congress wants to feel like we are sitting on our hands when we should be doing something helpful.

Will all be united in wanting to act? We are very much divided on exactly how we should act. These divisions exist within the parties, as well as between them.

In these circumstances, Mr. Chairman, I know it was not easy putting together a package to mark up. I commend you for the spirit of accommodation and good humor--your humor is so important--that has brought us through this process.

My basic problem with this tax cut goes back to the debate with the budget. We will be borrowing to make our way out of the tax cut, and that borrowing pushes deeper and deeper into our deficit.

Bigger deficits for a period of time might be acceptable if I felt more comfortable that these tax cuts would actually stimulate the economy to help the people who have been the hardest hit by the downturn.

But we are not talking about short-term efforts to revive a flagging economy. The effects of some of these changes will not be felt for years to come.

We are offered a long-term, dubious solution, but hopefully we have just got a temporary problem. Admittedly, many of these tax provisions sunset or phase out, but this is not really because they are intended to be temporary. Rather, it is because we just cannot hit the budget targets unless we jiggle the numbers with sunsets and phase-outs.

We will be back here trying to breathe life into more expiring provisions. In my view, we should be focusing our efforts on temporary measures. I have reservations about this package because I do not believe that many of the tax provisions will help the people most hurt by the economic downturn.

The folks who will reap the majority of the benefits from cuts in the top tax rates and by exempting dividends from the tax are not the ones that need the help.

In my State of Vermont, taxpayers with incomes in the top bracket account for less than 2 percent of all taxpayer; 71 percent of the tax returns of Vermonters show no dividend income. We could do much better in targeting our efforts.

In my view, the most important thing we could do

right now is to extend and expand the unemployment insurance program. Unemployment levels hit an eight-year high last month. Over the next six months, another two million people will exhaust their unemployment benefits.

At the same time, jobs are disappearing with the economy. These people want nothing more than to find regular work, but the economy is not creating jobs for them. They cannot afford to wait until the new jobs trickle down from a tax cut.

They need help now. The temporary extended unemployment compensation program we enacted last March will begin to expire at the end of this month. Unless we act soon, workers receiving these benefits will lose a lifeline.

Second, I think we should take steps to help out the States who are facing dire budget crises. I commend the Chairman for modifying the mark to include aid to the States, and I wish that it had been larger. In many States, cuts in federal taxes are automatically translating into more cuts in States revenues.

Already, States are cutting important programs to balance budgets. They are postponing homeland security efforts. They are cutting back on medical assistance to the needy. They are laying off teachers and cutting back on education at a time we are in desperate need of

improving education in this Nation. We seriously lag behind our European and Asian competitors.

In this regard, even more dangerous to our future, is the newly-created child care education programs are being terminated or indefinitely delayed by States. This is a serious blow to a serious national program, especially compared to our economic competitors.

They are desperate. In one State, they are unscrewing every third light bulb to save money. These kinds of cutbacks undermine our standard of living and jeopardize our future.

When millions of Americans are experiencing long-term unemployment and facing draconian cuts in basic State services like health care and education, this committee's response is to cut the top tax rate and create an exclusion for dividend income.

I believe these priorities are misguided. This approach ignores those who are most in need of help and helps those who need it the least. It is the wrong approach.

Thank you, Mr. Chairman. It is a pleasure to work with you.

The Chairman. Yes. Thank you very much.

Now we would go to what we call the walk-through. I have an opportunity to remind people again that our new

director, Mr. Yin, is with us, and he is going to do that.

I also want to name other people that might be involved in answering questions for members. We have Greg Jenner, the Deputy Assistant Secretary for Tax Policy at the Treasury Department. We have Ed McClellan, Tax Counsel for the Finance Committee, and not yet at the table, but Steve Robertson is going to be available.

What I am going to do, although if anybody wants to interrupt for questions I would not rule them out of order, but I would like to have Mr. Yin give a very short review of the original mark put before the members 48 hours ago, and then I would like to have a little longer review of the modification of the mark.

So, Mr. Yin, I would call on you. If we could, I would like to go all the way through the mark. But if somebody wants to interrupt at that time, it is all right.

If we would go through the mark and then come back and go to any questions anybody wants, because everybody is entitled to a full explanation if there is any doubts about what our mark tries to accomplish.

Mr. Yin?

Mr. Yin. Thank you, Mr. Chairman, members of the committee.

In the original mark that is unmodified by the Chairman's modification are all of the recommendations in the President's growth package with respect to the acceleration of rates and the acceleration of the relief for the marriage penalty, and the acceleration of the child tax credit up to $1,000.

In addition to that, there is an expansion of the Section 179 provision for expensing for small businesses, to increase the amount from $25,000 to $75,000, and to increase the threshold phase-out amount from $300,000 to $325,000. In addition, the provision applies to computer software.

For the remaining items, with your permission, I am going to work off of the document entitled, "Description of the Chairman's Modification to the Mark."

The first modification relates to an expansion of the exemption amount for the Alternative Minimum Tax. The exemption amount is increased to $61,000 for joint returns and $41,750 for individual returns for the years 2003 through 2005.

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus?

Senator Baucus. Mr. Chairman, just a couple of questions about AMT, here. As I understand it, as a consequence of--and I think you referred to this in your

statement--of the modification before us, there will be more taxpayers paying the Alternative Minimum Tax in 2006 and thereafter than would be the case under current law.

Mr. Yin. I believe that is correct, Senator.

Senator Baucus. And as I understand it, just for the record, there will be 3.6 million more taxpayers paying the AMT in 2006, 2.2 million more in 2007, again, that would not be paying under current law.

Mr. Yin. That is correct, Senator.

Senator Baucus. So, in effect, when we provide for phase-in for elimination of the marriage penalty, in effect we are pushing taxpayers up into the AMT category, that is, couples who would otherwise not have to pay AMT for those years 2006 and afterwards.

Mr. Yin. That is correct.

Senator Baucus. Does the committee have an estimate as to how much more taxes Americans are going to have to pay under this bill as a consequence of AMT at the beginning of 2006 and for the remaining six years of this bill?

Mr. Yin. Senator, I do not think we have calculated that.

Senator Baucus. Can you give us a rough estimate?

Mr. Yin. We can do it for you, Senator, but we just do not have the number right now.

Senator Baucus. Could you later today, before we finish the mark-up today, have that number?

Mr. Yin. Yes. We will certainly try to do that.

Senator Baucus. Mr. Chairman, I think an important point here is that we are taking action here today which is necessarily going to cause the Congress to, in future years, or next year, sometime soon, provide for additional AMT relief, and it is not going to be cheap. It is going to be pretty expensive after a while.

Second, a more subtle concern I have is that you have raised in your mark the AMT exemption amounts for single filers, and also for couples. My concern is that, when we get to conference, because so many Senators, and particularly House members, in conference are going to want to have an even greater dividend proposal than currently is the case, whether it is dividend exclusion or whatever it might be, that there is going to be a temptation to reduce the AMT exemption amounts.

There certainly is not going to be an effort to try to deal with the problems facing American taxpayers who would be paying AMT in 2006 and beyond, even though they would not be paying it under current law.

So, I flag that as a huge problem. Frankly, what it gets to, in part, is a fundamental point that has been discussed here, directly and indirectly. We would not

have nearly this AMT problem if the benefits under this bill were distributed to American couples with incomes of $61,000.

Or let me state it differently. The more that distributions under this bill go to couples under $61,000, or single taxpayers under roughly $42,000, the more there is not an AMT problem.

Or, conversely, the more of the income goes to taxpayers above those amounts, the more we have an AMT problem, I think, which gets to the question of distribution of benefits under the tax bill.

So, I am only pointing out, just to repeat, that we are creating a significant problem here in this bill with respect to AMT that we are going to have to deal with probably sooner rather than later, and it is not going to be cheap.

The Chairman. Even though we do not have the specific numbers you have asked for, and we will get those, I think common sense would dictate that you have described a situation that would evolve to some extent, so I would not dispute you there.

I would like to emphasize, though, that for taxpayers who would have otherwise been hit by AMT through 2005, we have made that situation much better with our legislation.

Senator Baucus. That is right. Those taxpayers are held harmless through 2005 as a consequence of this bill. It is just those American taxpayers after 2006 that are going to face the problem.

The Chairman. At one time, I think it was 1999, Congress did recognize the injustice of the AMT, particularly on middle income taxpayers, and did repeal it, and that bill was vetoed.

Mr. Yin?

Mr. Yin. Thank you, Mr. Chairman.

Item 1B is a partial exclusion for dividend income from tax. This would apply to the first $500 per tax return reporting dividend income and would exclude that from income.

In addition, for the years 2004 through 2007, there would be an additional 10 percent of additional amounts of dividends excluded. For years 2008 through 2012, there would be an additional 20 percent of amounts above $500.

Part 2A involves a series of items----

The Chairman. Mr. Yin, Senator Baucus would like to have a quick question.

Senator Baucus. I would just ask a question there, too, if you do not mind. Again, the first $500 in dividends is excluded, and then 10 percent of dividends

above $500 is excluded through 2007. Then 2008 onwards, 20 percent above $500 is excluded.

Mr. Yin. Correct.

Senator Baucus. Now, does that mean that for most of those taxpayers, they will be doubly taxed on dividends? Those whose dividend income is above $500 will be doubly taxed.

Mr. Yin. Well, their situation would be unchanged from current law.

Senator Baucus. They will be doubly taxed.

Mr. Yin. Well, certainly to the extent the corporation is paying that.

Senator Baucus. So this provision does not, except for those received dividends of $500 or less, deal with the basic problem of double taxation of dividends, as is supposed to be a main reason for this bill, to eliminate double taxation of dividends.

Mr. Yin. The Senator is correct, with the exception of the 10 percent and 20 percent amounts.

Senator Baucus. Well, 99 percent would be taxed above $500.

Mr. Yin. That is correct, Senator.

Senator Baucus. That is double taxation of dividends. So, many dividends would be doubly taxed. In fact, I would guess that, in dollar terms, certainly most

dividends would be doubly taxed as a consequence of this bill.

Second, is it not true that in some cases no dividends would be taxed whatsoever? That is, for companies who have no income, companies who have large subsidies for one reason or another?

Or to say it differently, is it true that this provision with the 10 percent and the 20 percent eliminates the EDA and other complicated provisions that were in the President's original provision for the exclusion of dividends?

Mr. Yin. The Senator is correct.

Senator Baucus. So it is a straight $500, 10 percent, 20 percent, irrespective of EDA accounts and all of that that we were going through earlier.

Mr. Yin. The Senator is correct. Exactly right.

Senator Baucus. Which is to say that a company may have no income under this provision and may receive tremendous tax benefits and still pay dividends.

Mr. Yin. If it qualifies as a dividend under current law, then, yes, Senator, that is right.

Senator Baucus. What would prevent the company from paying dividends?

Mr. Yin. Well, if a company had no earnings and profits, then their distributions would not qualify as

dividends in the current law.

Senator Baucus. Could the company not borrow?

Mr. Yin. The company could borrow.

Senator Baucus. The company could borrow and pay dividends.

Mr. Yin. Well, again, if it had no earnings and profits it would not qualify as a dividend under current law. But if it does have earnings and profits, then, yes, the distribution would qualify as a dividend.

Senator Baucus. Again, it is possible that the American taxpayers, to some degree, are subsidizing the payment of non-taxable dividends under this mark.

Mr. Yin. The Senator is correct that the provision does not tie to the amount of taxes paid to the corporation.

Senator Baucus. All right. Thank you.

Mr. Yin. Continuing on. In Part 2A, there is a series of proposals which are designed to curtail tax shelters. These proposals all have previously been approved by the committee in the CARE legislation.

The principal item is item number one, which clarifies the Economic Substance Doctrine to try to ensure a somewhat more rigorous and uniform application of the doctrine by the courts.

Most of the rest of the items involve additional

penalties and reporting requirements imposed in tax shelter-type situations.

In Item 2B are two additional items which have been previously approved by the committee in the energy legislation. The first relates to the Write Aid case and simply affirms the Treasury's ability to write consolidated return regulations relating to consolidated groups, the second requires CEOs to sign corporate income tax returns.

Part C involves some additional tax shelter-related provisions that were described in the Enron report. The biggest item is number one, which involves attempts to prevent the importation of losses which accrued outside of the United States into the United States, and to prevent the deduction of those losses once they are imported. The provision also extends to certain transactions involving the potential duplication of losses.

Item 2 involves a provision which prevents the reduction in basis in corporate stock of a partner in a Section 734 adjustment. Item 3 involves a special set of rules involving pass-through taxation called FACETS. The Enron report identified certain ways in which these rules were being misused.

Item 4 involves expanding the disallowance of the

interest deduction to certain kinds of convertible debt. This is an expansion of an existing provision relating to debt which is paid in equity.

Item 5 involves an expansion of the authority under Section 269. This is a general provision intended to prevent tax avoidance transactions, and this simply extends that authority to a slight extent.

Item 6 involves a problem involving an overlap of two anti-deferral provisions which are intended to prevent the deferral of taxation of offshore income in inappropriate situations, and this provision attempts to rectify the problem identified.

Item D involves a provision which the committee has previously agreed to or approved in the military bill involving individuals who expatriate. This would impose a mark-to-mark tax on such individuals, with a $600,000 exemption.

Item E extends the IRS's user fees for certain rulings and certain other types of items that taxpayers use. Item F is an item that the committee has previously agreed to in the energy legislation.

The principal item here relates to so-called corporate inversions. What this provision would do, is if there is an 80 percent or greater continuity of shareholder interest following the inversion, the

provision would treat the new foreign parent company as a domestic company and there is, in addition, a provision relating to situations where there is a 50 percent continuity.

Item G extends the excise tax to certain vaccines against Hepatitis A. Item H involves certain transfers of partnership losses from one taxpayer to another. There is a series of rules in the partnership area that attempt to prevent the shifting of losses between taxpayers, and this simply extends it to one other situation.

Item I provides additional authority to the Treasury Department to treat the taxation of income items that have been separated from their principal in an economically appropriate way.

Item J involves a reporting requirement imposed on the acquiring company in certain merger and acquisition transactions.

Item K prevents the deferral of income from offshore trusts, and also will restrict the deferral of income from certain deferred compensation arrangements unless they only permit distributions upon separations from service, disability, death, and certain other situations.

Item L extends the current law rule in Section 901(k) which applies to dividends to certain other kinds of

income from certain other kinds of investments to require a holding period for the taxpayer to be entitled to a foreign tax credit for the withholding taxes.

Item M was an item in the President's budget which would permit the IRS to utilize private sector debt collection companies to collect tax debts.

Item N would repeal the special provision in the Internal Revenue Code which allows an $80,000 exemption, plus certain housing costs for certain taxpayers situated abroad. These taxpayers would be permitted to receive a foreign tax credit for any foreign taxes that they pay against the U.S. taxes that would be imposed. This provision has a delayed effective date to 1/1/05.

Senator Breaux. Mr. Chairman?

The Chairman. Senator Breaux?

Senator Breaux. May I ask, on the significance of that, how does that change current law?

Mr. Yin. Yes, Senator. Current law attempts to avoid the international double taxation of certain persons who are situated abroad by permitting them to exempt from U.S. taxation $80,000 of their earned income, plus certain housing costs.

To the extent, of course, those people are subject to foreign taxes wherever they are situated, then to that extent they are only going to be subject to the foreign

tax rather than the U.S. tax.

Senator Breaux. Up to $80,000?

Mr. Yin. Yes.

Senator Breaux. If they earn over $80,000, the excess is subject to complete U.S. tax, even though they have paid foreign tax on it, under current law?

Mr. Yin. That is correct. But the would be entitled to a foreign tax credit if they paid foreign taxes on that.

Senator Breaux. Even over $80,000 of income?

Mr. Yin. I believe that is the case. Yes, sir.

Senator Breaux. What is the effect of the cap then? Why the cap if you have got the credit against everything?

Mr. Yin. Well, Senator, that is a very good question. What this provision would do, would be to eliminate the exemption so it would allow the first dollar to be credited. It would principally affect taxpayers who are situated abroad in low-tax foreign countries. If they are in high-tax foreign countries, then they would get a credit against their U.S. taxes.

Senator Breaux. I have got a lot of oil and gas workers from Louisiana, as an example, that do work in the North Sea and in other parts of the country, and they pay taxes in that country on their first $80,000 worth of

income. Currently, they can deduct that when they bring that money back because they pay taxes overseas. My question is, how does this change that? Is this a revenue raiser?

Mr. Yin. Yes, this would be a revenue raiser. Those people you are describing would be entitled to a foreign tax credit for the foreign taxes that they pay. To that extent, they would not have to pay international double taxation.

Senator Breaux. But they pay the full tax on every dollar they bring back.

Mr. Yin. The Senator is correct. To the extent they are paying taxes in the foreign jurisdiction, they would pay those foreign taxes and then they would be able to credit those taxes, subject, of course, to the normal foreign tax credit limitations against any U.S. tax as well.

Senator Breaux. But currently it is a total exemption on that first $80,000. This is a big tax increase for a lot of people that I represent. We never had a moment of hearing on it. Nobody has ever talked about it. I do not know where it came from.

Mr. Yin. Senator, I am sorry.

Senator Breaux. It is just a statement. I mean, it is a huge tax increase for a lot of people that I

represent and anybody who has any workers that work overseas. This is a huge tax increase. We have not had a word of testimony on this. I do not know where it came from.

The Chairman. Could I have Mr. McClellan, maybe, speak to that point, Senator Breaux? Then you can dialogue with him.

Mr. McClellan. Senator Breaux, a second component of the current $80,000 exemption concerns a certain qualified housing allowance that is paid by the company to the employee, often in the form of housing that is provided to the employee overseas.

There may be certain fringe benefits, such as housing allowances or car allowances, that would normally be taxable in the United States which, in fact, may not be taxable in the foreign jurisdiction.

It is possible--and I would have to ask our revenue estimators--that the revenue increase may relate to those items because those items may be taxable for U.S. tax purposes, but not taxed in the foreign jurisdiction.

If they are not taxed in the foreign jurisdiction, then there would not be a commensurate foreign tax credit on those items of income that would carry back to the United States to offset the taxable income.

What this measure does do, however, is to put

individuals overseas on an equal footing with individuals who live and work in the United States. If those items would be taxable to them in the States, then it would be treated as taxable to them overseas.

Senator Breaux. I understand that. But this is a tax increase. It is a fundamental change. It is hard to consider how you are going to talk about living on an offshore oil rig in the North Sea as something we ought to be taxing as a housing allowance.

Mr. McClellan. Well, that sort of housing allowance, Senator, in fact, may not be taxable under the U.S. Code. It is a very complex set of provisions under Section 132. If an individual is required to live on the premises as a condition of their employment, generally that sort of provision of housing is not taxable to the individual. So, it is actually quite possible, depending on the actual circumstances.

Senator Breaux. I do not want to belabor it. But we fundamentally are eliminating the $80,000 tax exemption on overseas income.

Mr. McClellan. That is correct.

Senator Breaux. How much does this raise?

Mr. McClellan. I believe it is $32 billion over 10 years.

Senator Breaux. Thirty-two billion dollars? It is

a $32 billion tax increase. I mean, we never had a word about this. Thank you.

The Chairman. Proceed, Mr. Yin.

Mr. Yin. Item O involves a modification of the definition of certain property and casualty insurance companies that are currently exempt and would change the definition limited to companies that have gross receipts of $600,000 or less and that have premiums at least equal to half of those receipts.

Item P would authorize the IRS to enter into installment agreements that permit the partial payment of taxes. Item Q would clarify and broaden slightly the provision in the statute that disallows the deduction of certain fines and penalties.

Item R would permit the making of deposits which would allow the taxpayer then to suspend the running of interest on under-payments.

Item S involves an estimated tax provision for certain deemed asset sales under Section 338(h)(10). Item T would limit the deduction of charitable contributions of patents and certain similar property to the taxpayers' basis in such property rather than the fair market value of such property. This would be effective as of the date of committee action.

Item U. Now we are getting into some of the outlay

items.

Mr. Robertson. Item U is the Temporary State Fiscal Relief fund. Essentially, this is a fund that is modeled after a provision that was in the Election Reform Act that was passed last year. It essentially creates a fund within the Treasury Department that is designed to distribute $20 billion in fiscal assistance to the States.

Item V is an extension of custom user fees. Essentially, under current law there are a number of fees that are imposed on customs, items that are brought into the country, and those would expire under current law. This is an extension of those provisions.

Item W is SSI redetermination. This is a provision that would essentially require an evaluation of all SSI disability applications that have been approved for disability benefits.

This is similar treatment that is provided under the current Social Security program for Old Age, Survivors, Disability Insurance. This provision has passed both the House and Senate previously.

Item X is a provision that would essentially restate current law, or the intent of Congress with respect to current law. That is that the Children's Health Insurance program should not provide health insurance to

childless adults. It is simply a clarification that that was the intent of Congress back in 1997. I believe that is the end of the provisions.

The Chairman. Mr. Yin, does that complete your walk-through?

Mr. Yin. Yes, it does, Senator.

The Chairman. All right.

Now, for members, what we would like to do, and I have discussed this with Senator Baucus, is we would have questions now, if there are any. Then if there are not any, we will go to amendments.

I have been informed by staff that we have two votes at 1:45, so Senator Baucus and I would like to continue until those votes and then reconvene.

I did not discuss this with Senator Baucus, but I assume we will reconvene immediately after those two votes are over. I also need to remind my colleagues that we need at least seven of us here to conduct business on amendments.

Yes, Senator Breaux?

Senator Breaux. You said if we had questions it would be appropriate to ask?

The Chairman. Yes, right now.

Senator Breaux. Did I miss the discussion you had on the section dealing with state fiscal relief? Did you

all cover that?

Mr. Robertson. Very briefly, yes.

Senator Breaux. Let us have a little bit more questions about it, then. Are there any tax provisions in the State fiscal relief section?

Mr. Robertson. No. The fiscal relief provision is designed to be strictly an outlay. It would essentially follow a provision that Congress enacted last year in the Election Reform bill where Congress set up a fund to provide assistance, payments to the States to purchase election equipment and things related to reforming the election system.

Senator Breaux. Are there any restrictions on how the money can be used by States?

Mr. Robertson. There are a number of items that would be listed. For example, the States could use the funds to provide education assistance, transportation, health care, law enforcement, public safety, and essential government services.

Senator Breaux. Or other essential government services. I mean, it is really "Katie, bar the door." Whatever you want to do with it, you can use it.

Mr. Robertson. Yes, Senator. It is basically a broad, permissive allowance that would permit the States to use the money for basically any legitimate State and

local governmental purpose.

Senator Breaux. And it is divided equally, 50/50, between States and local governments?

Mr. Robertson. The provision, as currently drafted, would provide a 50/50 split between the funds. There has been some discussion among a number of members whether that 50/50 should be 60/40 or 75/25, but the current provision is 50/50, yes.

Senator Breaux. So under that formula, it is conceivable--I mean, it certainly would be legal--that no State would have to spend any money for health care.

Mr. Robertson. That is correct. It would be at the discretion of the State to state that its intended purpose or use of the money was for health care, education, or whatever it deemed was the most essential use of those funds.

Senator Breaux. But, again, there are no tax consequences to this section.

Mr. Robertson. None, no. It is essentially an authorization of a block grant to the States, to use a slightly different description.

Senator Breaux. All right. Thank you.

The Chairman. I do not want to muddy the water. I hope I addressed this in my opening comment, and probably the Senator from Louisiana was not here, because I

started out before very many members were here.

But the purpose of this is to give maximum flexibility for the adoption of policy on this very question that you are asking about on the floor of the Senate. I hope that I have accomplished that. That is my intention, at least. So, my intention would be to work with anybody that has interest in this area.

But the point was, there was a lot of interest outside of this committee on this very issue, and I felt that it was necessary to involve some of those people in the discussion on the policy.

Senator Baucus. Mr. Chairman, this is very unclear by the description. The description in this proposal--and that is all we have, is the description, therefore, it could be anything--is that this is $20 billion, equally divided among State and local governments, to be used for education or job training, health care services, including Medicaid, transportation or other infrastructure, law enforcement or public safety, and other essential government services.

Well, many questions come to my mind. First, is who is going to decide how this money is spent? I am asking the staff, or whoever has the answer.

The Chairman. Could I answer? Staff can surely correct me if I am wrong. Even though you are my

employee, you still correct me. [Laughter].

It is meant to be for the policy to be adopted by a majority vote of the Senate, on the floor of the Senate, of how this $20 million is spent. I am committed to maintaining the $20 million. I would object to any policy that would have less than the $20 million. I suppose I would also object to a policy of more than $20 million.

Senator Baucus. Billion. B, billion.

The Chairman. Billion. Within that $20 billion, I would like to have all of the people who have expressed an interest in this get together on policy, as best you can get a consensus, on the floor of the Senate.

Senator Baucus. Well, Mr. Chairman, a lot of questions here. Is this a trust fund? Do you expect it to end up being a trust fund?

The Chairman. I had better let my staff answer the questions.

Mr. Robertson. Senator, let me clarify. The underlying bill that we are discussing today is a revenue bill. Normally, if you took a revenue bill to the floor it would not be germane to offer the type of outlays that we have been discussing in the context of fiscal relief.

Senator Baucus. Is that true? Because we are not entitled to about $27 billion in outlays under the Budget

Resolution.

Mr. Robertson. Well, but those outlays are related directly to the refundable portion of child tax credits. So, they are essentially an outlay consequence of a revenue provision.

Senator Baucus. But does the Budget Resolution specifically say that it would have to be health related?

Mr. Robertson. No. It is not in the Budget Resolution that the point of order or germaneness issue lies, it is with respect to a revenue bill that the germaneness issue lies.

The reason this $20 billion is put in the revenue bill the way it is, is so that we can avoid the germaneness issue on the floor so that you can have an amendment to this provision crafted and done on the floor, and it will not require a 60-vote point of order, which would otherwise be the case.

Senator Baucus. How is this money to be distributed among the States?

Mr. Robertson. The current formula is designed on a per capita basis. So, essentially there is a minimum of $100 million per State, then all the amount above that, that would be basically $5 billion of the $20 billion. So, every State would get $100 million, then above that $100 million it would be based on per capita, whatever

each State's share of the population is.

Senator Baucus. Well, Mr. Chairman, this is all totally new to me. I am unaware of anything written anywhere that has any of these explanations as provided by staff. I do not know if that is agreed to, or if that is just an idea, or what.

Senator Rockefeller. I have a question on the same subject.

Senator Baucus. If the staff has specific answers to these questions, as they do, they have got to be written somewhere and I would like to know what they all are. There could be others that I am not anticipating.

Mr. Robertson. Again, Senator, this proposal is simply a placeholder. It is not intended to be a final proposal.

Senator Baucus. Well, it sounds like it is not a proposal then. It sounds like the $100 million floor you are talking about does not exist. Does it or does it not exist?

Mr. Robertson. We had to draft a proposal to have the score.

Senator Baucus. Where is the draft? We do not have a draft. We just have an explanation.

The Chairman. That is the way we have always done it.

Mr. Robertson. These are all conceptual marks. I mean, we have not provided legislative language with respect to this.

Senator Baucus. But where is the conceptual description of the $100 million, the population distribution, all those things?

Mr. Robertson. Actually, that is based on the Election Reform Act.

Senator Baucus. This does not say "Election Reform Act."

Mr. Robertson. No. I understand that. I think I can provide some paper to you.

Senator Rockefeller. Mr. Chairman, can I further ask a question?

The Chairman. We are going to let anybody ask any questions they want to ask. If Senator Baucus is done, you may proceed.

Senator Baucus. I am finished for the moment, but I have more questions on this subject.

Senator Rockefeller. This becomes, obviously, critical to the whole Medicaid matter. My understanding was that the committee staff was trying to draft this trust fund in a way that the parliamentarian would rule, as you said, that it was germane, and therefore would only require 50 votes.

I would ask you, has the parliamentarian ruled on this? It is not just a question of what you want, or what I want, or what the Chairman or the Ranking Member wants. The parliamentarian is going to make this decision. Has he ruled on this?

Mr. Robertson. I have not received a final ruling from the parliamentarian.

Senator Rockefeller. Well, I mean, do you think you ought to get up and go down and ask him right now?

Mr. Robertson. We will make sure that, before we finish up today, we will get an answer to that question.

Senator Rockefeller. Well, it is pretty crucial.

Mr. Robertson. No, I understand, sir.

Senator Rockefeller. I am due to give a fairly early amendment on this subject and it makes a very big difference. It is going to make a difference, frankly, in the way a couple of members of this committee vote.

Senator Nickles. It will not change my vote.

Senator Rockefeller. I am aware of that, Senator.

The Chairman. Before I call on Senator Bingaman and Senator Conrad, it may be in dispute exactly the wording and the concept of what it does, but I hope that there is an understanding of the purpose of it, not only for what we want to accomplish in the end, that you and I want to accomplish the same thing, only at maybe a different

level.

Senator Baucus. Add me in there.

The Chairman. You, too, at a different level as well.

Senator Nickles. Would the Chairman yield?

The Chairman. That is parliamentary possible and that the policy is not being written here on the floor. If there is an understanding that that is the motivation behind it and that there is no mouse-trapping involved in this so that we end up with no State aid, if that is what might worry any of the Senators here. I am going to make sure that that does not happen.

Senator Nickles. Would the Chairman yield?

The Chairman. No. I have to call on Senator Bingaman.

Senator Rockefeller. Well, Mr. Chairman, I had not totally finished in this respect.

The Chairman. All right. Senator Rockefeller.

Senator Rockefeller. I really do not know when this was taken to the parliamentarian, if it has been taken to the parliamentarian, whether the parliamentarian indicated where he might or she might respond. But we need that response.

I understand the good intention, which I have come to expect of our Chairman. But the parliamentarian is

crucial to this. The information about whether he rules yes or no, 50 or 60, is crucial.

The Chairman. If you would let me interrupt, that was very basic to our consideration of doing it this way and wanting to accomplish that.

Now, whatever we need to do to satisfy Senator Rockefeller, Senator Baucus and maybe a lot of other Senators, we need to do that. But I do not think we should find fault with the conceptual approach that we are doing in drafting legislation because this committee has always used that conceptual approach.

Even if it comes to the biggest tax increase in the history of the country, we have always used that approach. We adopted the concepts and then the basic legislation was written between our final action and action on the floor.

Senator Rockefeller?

Senator Rockefeller. Would the Chairman grant this Senator that we would have an answer to that question of the parliamentarian, and presumably written, one or two sentences, before my amendment is voted on?

The Chairman. Let me ask if that is doable.

Senator Nickles. Mr. Chairman? I do not think that is necessary. One, we have done----

The Chairman. I will go to you, but I have not

forgotten the other two yet, because I think it is germane to the point right now. I will try to get Senator Rockefeller an answer. Go ahead.

Senator Nickles. Senator Rockefeller, one, we have done conceptual mark-ups. The concept is to have a placeholder so it would be ruled germane on the floor. That is what Senator Grassley is trying to do, and I think trying to defer to the floor to the final language in the composition, the outline, and structure of the $20 billion package, which was, I think, pretty much agreed to it was going to be $10 billion a year for two years.

But, again, basically punting at this point in time, making sure that we had a placeholder in there so a germaneness point of order would not be made.

Also, just for your information, this is paid for. There are offsets in the bill to offset this so there would not be a budget point of order dealing with the outlays, which Senator Baucus alluded to.

Senator Rockefeller. And I understand that. I understand what the Senator from Oklahoma is saying. But every member has a right here to offer amendments, and my amendment is going to be for 30, not 20, which is what 80 people voted for, including three-quarters of this committee, on the floor.

Therefore, I think, if we get an answer for the 20, I

need to know whether that is going to apply to the 30. If it just applies to the 20, then my amendment undergoes an entirely different future on the floor, potentially, than does the 20.

I think I have come down from 40 and I am at 30. I think it is equally divided in a way that the Chairman would be comfortable with. But, frankly, the 20 does not tell me about the $30 billion amendment.

The Chairman. Senator Bingaman?

Senator Bingaman. Thank you, Mr. Chairman.

Let me ask a question on this issue, then on one other issue. The way I read this, this is just authorizing language.

Mr. Robertson. The intent is to both authorize and appropriate. It would be an entitlement so it would not be subject to the appropriations.

Senator Bingaman. So we are setting up a new entitlement.

Mr. Robertson. Well, that would be one way to view it. A temporary one.

Senator Bingaman. A temporary entitlement that could cover any of these subjects, law enforcement, safety, transportation, infrastructure.

Mr. Robertson. That is correct.

Senator Bingaman. Mr. Chairman, I am not sure--I

mean, I have not really studied it--but the jurisdiction issue. We have got a lot of other committees around the Senate who claim jurisdiction over many of these subjects here that we are now proposing to set up an entitlement to fund. What is the revenue stream?

Mr. Robertson. Well, there are two issues. That is one of the reasons we wanted to defer the substance of this to the floor, is so that the other committees of jurisdiction would be able to have input into what the final amendment ultimately is.

But in terms of the $20 billion, essentially the way it is designed, under reconciliation we are allowed $350 billion. So in order for us to put this $20 billion in additional outlays that will be provided to the States, we had to find some offsets within the bill which we just ran through a whole long list of earlier, that gets the net number down to the 350.

Otherwise, the $20 billion would be on top of the tax cuts, on top of the refundable child credit, and we would exceed the allocation and would not be in compliance with the Budget Resolution.

Senator Bingaman. Well, Mr. Chairman, I am just still confused about this. I always thought, when you get outside the areas that the committee has specific jurisdiction of, like Medicaid, Medicare, and these kinds

of issues, then you have to involve the Appropriations Committee if you are going to spend money.

This seems to try to just side-step that and say, we are going to be authorizing and appropriating the money for a variety of things that are not in our jurisdiction. No one has ever argued they were, but it just seems to me an unusual proposal.

The Chairman. I hope you see our effort as one of being flexible in trying to help get to a mutual goal, and do it in a bipartisan way as well.

Senator Bingaman. I respect that. I know Senator Rockefeller--at least I assume--is going to propose to get money to the States pursuant to some of the programs this committee has jurisdiction of. For example, Medicaid, FMAP, for example. That seems to me to make good sense, and I would support that. I may support this, too.

But let me ask one other question, if I could ask the representative from the Treasury Department. This provision that limits this changed tax treatment for dividends received from domestic corporations. Does that run us afoul of any of our trade agreements?

Mr. Lyon. From what we have determined so far, Senator Bingaman, as a technical matter, it would not violate non-discrimination rules of our tax treaties.

Those rules are very, very limited. So, the technical answer is, no, I would not.

Senator Bingaman. What about the non-technical answer?

Mr. Lyon. As it now exists, apparently 15 OECD countries provide dividend relief at the shareholder level, and 10 of those do not extend similar benefits to U.S. corporations paying dividends to those shareholders, including the U.K., I note. So, there is precedent under the current situation for doing what is done.

Having said that, the differential treatment will distort behavior, investment choices, and as a result is subject to some concern.

The Chairman. Senator Bingaman, as I told Senator Breaux, I think he referred to this once before, we want to take care of this. This is a major problem. We did not intend this problem to be here. We were dealing with some language from another document and did not realize that this had this impact. I have an amendment that hopefully will take care of it to your satisfaction.

Senator Bingaman. Thank you.

The Chairman. Senator Conrad?

Senator Conrad. Thank you, Mr. Chairman.

Could I direct the staff's attention to this document? "Joint Committee on Taxation" is in the upper

righthand corner, "May 8, 2003, JCX-03." That is the summary document that is before us.

There is, to me, a curious thing. On the fourth page, on footnote number 13, it says, "Includes the following outlay effects for 2003," and it has "$4.3 billion."

But if you go to the document itself, for example, on page 3, the State Aid Trust Fund alone is $14 billion of outlays. In fact, as we cumulate the totals, the outlay for 2003 is not the $4.3 billion, but instead is $18.3 billion.

For 2004, the document on the fourth page says outlays are $1.1 billion, but in fact we find that the outlays are $5.75 billion, including the State Aid Trust Fund of $6 billion. So, somehow this does not add up.

Senator Baucus. Senator, I see your footnote 13. What is the other information you are referring to?

Senator Conrad. What I am referring to, is for 2003, it shows outlay effects of $4.3 billion.

Senator Baucus. Right. That is footnote 13.

Senator Conrad. But as we cumulate the total, it is over $18 billion. They have left out the $14 billion for the State Aid Trust Fund. That is an outlay. In 2004, they show outlays of $1.1 billion. Yet, as we cumulate the totals, it is over $5.7 billion.

Senator Baucus. Good question.

Mr. Robertson. Senator, if I could respond to that. This document was prepared by the Joint Committee on Taxation. The footnote refers to the revenue items in this document. So, the figures that you refer to in the footnote are the outlay effects that are associated with the refundable portions of the revenue provisions.

Senator Conrad. It is not meant to describe the full outlay effects for those years?

Mr. Robertson. That is correct.

Senator Conrad. Can I just recommend for the future, then, that that be marked in a way that is clear?

Mr. Robertson. All right.

Senator Conrad. Because I think it was at least confusing.

Mr. Robertson. Yes. The difficulty is, this document was prepared, 99 percent of it, by the Joint Committee. The outlay items were added at the end, and the cross-reference back to the footnote was not done. But you are correct. That should be been done.

The Chairman. Mr. Yin, since this is your document, I want to make sure you agree with that explanation that was given. We probably should have had you respond to it.

Mr. Yin. Yes. Thank you, Mr. Chairman.

Mr. Robertson is correct. My understanding is, footnote 13 does relate to the outlay effect of the child tax credit.

Senator Conrad. So it is not the full outlay effect.

Mr. Yin. That is correct, Senator.

The Chairman. Senator Rockefeller?

Senator Conrad. Mr. Chairman, I am sorry.

The Chairman. Oh, no. Go ahead, Senator Conrad.

Senator Conrad. I am sorry. While I had the floor, I wanted to respond, if I could, just to something that was said by a colleague suggesting that we on our side had proposed some $500 billion of spending on the Omnibus appropriations bill. That is just not correct.

What the Senator did, is take one-year amendments and make them into 10-year amendments. They were not 10-year amendments, they were one-year amendments. So, his totals are absolute fiction.

Number two, we did not offer those amendments in a package. We offered them individually. Even if you added them up individually and cumulated them, which you could not do, they add up to $37 billion, not $500 billion. Thirty-seven billion.

And, interestingly enough, the Republicans in the conference committee added $63 billion in spending over

the mark that was on the floor, $26 billion of spending over and above what we had offered in amendments. So, let us not be making things up here about what people have proposed on spending.

On the Budget Resolution, we did propose spending that was 19.3 percent of GDP compared to their proposal of 19 percent of GDP. But we put in the funding for the war. We put in that money the President requested. We also put in the money for additional funding for homeland security. So, I just wanted to set the record straight.

The Chairman. Senator Rockefeller had a further question.

Senator Rockefeller. To Mr. Yin. It is all well and good for us to have a conceptual approach. The parliamentarian will not react to a conceptual approach to whether something is germane or not. It has to be written. He or she has to respond to a written approach.

I wish to know if this committee has prepared such a written approach so that the parliamentarian can respond to it, as to the matter of whether 50 or 60 votes would be required.

Mr. Yin. I am not familiar with whether there has been anything in writing prepared on that.

Senator Rockefeller. Well, is somebody familiar? Because it is fundamental. The parliamentarian cannot

rule on a concept.

Mr. Yin. If you are referring to the $20 billion item, I think Mr. Robinson will be better.

Senator Rockefeller. Yes. All right.

Mr. Robertson. We have some draft language that I thought I understood was going to be shared with the members. As a normal practice, I do not think the entire bill is written in legislative language at this point.

We do, however, have some legislative language with respect to the $20 billion. My understanding is, that was being shared with the parliamentarian. We were waiting for a reply from him.

Senator Nickles. That is correct.

Mr. Robertson. So that is where we are. If you do not have a copy, I understand the folks----

The Chairman. But I think, regardless, for Senator Rockefeller's benefit, what we say and hear, your amendment, if it were adopted, would take the place of this.

So you are going to have your own policy spelled out in your own amendment, so we are going to assume you are going to write your policy. So, it will be the way you want it, and presumably you would try to avoid a 60-vote margin, I would guess.

Senator Rockefeller. Well, Mr. Chairman, that is

correct. But I also would not want to think that a $20 billion approach to one problem would be germane and that a $30 billion approach to exactly the same problem, if it were passed by this committee, would suddenly become not germane. That is why I feel very strongly about the parliamentarian ruling.

The Chairman. Well, the answer to that is, if your amendment is adopted, that is in the bill before the Senate.

Senator Nickles. That is correct. Then there is not a germaneness problem.

Senator Snowe. Mr. Chairman?

The Chairman. Senator Snowe?

Senator Snowe. Might I pose a question in reference to the germaneness issue? Because historically there have been similar types of approaches that have been referred to this committee.

I mean, back in the 1970s and 1980s, we had revenue sharing. The legislation that I introduced with Senator Shumer was similar to the approach taken here, but it was for $40 billion, divided between State and local governments for the purposes of unemployment or the basis of population. Jurisdictionally, it was referred to the Senate Finance Committee. So, I think that there is ample precedent for this legislation to be considered.

The Chairman. Senator Baucus had a question.

Senator Baucus. If I might just follow up, because this is extremely important to so many Senators. I did not quite hear. Senator Snowe, what had been referred to this committee?

Senator Snowe. Legislation that Senator Shumer and I had introduced for similar purposes, and it was referred to this committee. The legislation would have provided $40 billion in assistance to State and local governments and some of it was based on population, other parts of it was based on unemployment insurance.

Senator Baucus. Right.

Senator Snowe. Back in the 1970s and 1980s, on revenue sharing, the jurisdiction of this committee applied to that legislation as well, so there is ample precedent.

The whole purpose in designing, as I understand it from the Chairman, and creating a placeholder in this legislation was to ensure that, one, it obviously would be germane, it would be designed for that purpose, but second, to make sure there were offsets so that it is not subject to a budget point of order on the floor and requiring 60 votes. It is protected within the 350 in this legislation.

Senator Baucus. Then it appears, because this is

scored as $20 billion, that therefore is not authorizing language, it is outlays, in budget jargon. The assumption is that this language, too, would therefore not be subject to a point of order because it is not offset.

That is, an amendment on the floor offered by any Senator on the basic subject of State Aid, FMAP, or whatnot, the hope is that, because of this provision, that the parliamentarian would rule that such an amendment, offered by Senator Rockefeller or whomever, would be not ruled not germane. It would be ruled germane. That is the hope.

So, this whole discussion here is based upon that hope, as I understand it. If that hope does not materialize, then that is going to be very difficult to get State aid passed on the floor.

I think Senator Rockefeller makes a good point, that we should, to some degree, have, if we can at all possible, a ruling by the parliamentarian on that issue so we know whether our hope is well based or not.

Mr. Robertson. I have just been told we are getting that answer as soon as we can.

Senator Rockefeller. I apologize, but I need to pursue this. The answer that came to me from the other side of the aisle when I said this, is you are all right,

because if it passes here it will be in the bill. Well, that is obvious. If it does not pass here, any Senator has a right to make an amendment on the floor, and it could be the same amendment, and probably would be.

So, the effect of the parliamentarian's ruling on the floor to a floor amendment is obviously critically important to this Senator. Thus, it is not just whether it passes this committee, but what is the effect on the floor if a $30 billion amendment is offered? I think the Senator has a right to know the answer to that from the parliamentarian.

The Chairman. Does Senator Baucus have some more questions?

Senator Baucus. No, I am fine.

The Chairman. All right.

Before we go to amendments, I think what we will do, is we have got to get one more member here. I announced that we had to have seven people. I announced that we were going through and asked some Republicans if they wanted to get a tax bill out or not. We cannot expect the Democrats to move product that they do not want. [Laughter].

I was going to move the Chairman's modified mark. I now move to modify the Chairman's mark, without objection.

Senator Breaux. Mr. Chairman?

The Chairman. Go ahead, sir.

Senator Breaux. We need to know what is in the modification that we are proposing here. I take it you are not moving to adopt it, you are just asking, you have a right to modify your mark. Are we asking for a modification of the mark?

The Chairman. I have withdrawn my modification of the mark.

We are going to stand in recess until 2:30.

AFTER RECESS

[2:40 p.m.]

The Chairman. I am going to ask Mr. Yin to describe the modification on the modification, then we will proceed to amendments after that is done. Likewise, we will take questions, if there are questions, on the modification of the modification.

Proceed, Mr. Yin.

Mr. Yin. With the Chairman's permission, if I could respond to the question that Senator Baucus raised with me this morning.

The Chairman. Yes, go ahead.

Mr. Yin. Senator Baucus asked what the revenue cost would be of holding harmless all taxpayers from the AMT under the Chairman's modification. The answer is $23

billion over the 10-year period.

Senator Baucus. Twenty-three billion dollars. That is, taxpayers will pay an additional $23 billion through AMT as a consequence of this bill, although it does not begin until 2006.

Mr. Yin. Yes, that is correct. It would not begin until 2006. The Senator is correct.

Senator Baucus. Thank you. Thank you. Thank you very much for getting that, and thank you for bringing it up right away, too.

Mr. Yin. You are welcome.

Senator Conrad. Mr. Chairman?

The Chairman. Senator Conrad?

Senator Conrad. Might I make inquiry of the staff?

The Chairman. Yes, proceed. Yes.

Senator Conrad. On page 4, again, if I could refer you to the summary document that we have been provided, in footnote 11, it says, "Estimate provided by the Congressional Budget Office." Is that true?

Mr. Yin. Senator, that is correct. This is an outlay provision, and to my knowledge, the Joint Committee on Taxation did not estimate this figure, this item.

Senator Conrad. And so the assertion here is that the Congressional Budget Office provided it?

Mr. Yin. The Senator is correct.

Senator Conrad. The Congressional Budget Office says they did not provide it. The Congressional Budget Office told us they did not see it until two hours ago and they did not provide that estimate.

Mr. Yin. I am sorry, Senator. I thought footnote 11 referenced several different places on the sheet. But if you are referring to the State Aid Trust Fund item----

Senator Conrad. Yes.

Mr. Yin. [Continuing]. That would not be a correct statement. The statement on the sheet here would not be a correct statement. CBO did not provide that.

Senator Conrad. Mr. Chairman, if I could just say, that is troubling to me when a representation is made to us that estimates have been made by the Congressional Budget Office and they have not. That is not the way we ought to be doing business. I know the Chairman would believe that and feel that way. I am sure he would.

The Chairman. Well, let me make a statement along that line. As Chairman of the committee, and as a person that, along with Senator Baucus, that is on the Joint Committee on Taxation, I would just ask the committee to be more careful of that in the future. I do not know what more I can say at this point, except deliver on my pledge.

Senator Conrad. The question that follows, if I can say, is who did make the estimate?

Mr. Yin. Senator, let me apologize that the footnote is incorrect. It was our fault, so it is our error. In terms of who made it, we were provided with the $20 billion number by the Finance Committee.

Senator Conrad. All right. If I could follow up, because we have got a whole series of issues that flow from this. I know these are technical questions. That one is not technical, but there are others that are technical in nature. But they have an implication about what will follow.

Senator Rockefeller, I think, is clearly under the impression that fungibility would apply and he would have an opportunity on the floor to offer an amendment for a bigger pot of money going to assistance to the States.

We have inquired of the parliamentarian and we are informed that that may well not be the case. The parliamentarian has not seen amendment language, for understandable reasons. I am not faulting that.

But they are saying that it may be a circumstance in which you could not reduce the size of the tax cut to increase the amount of money going to States. The only way you could do that, you could not do it out of the tax component.

The only way you could do that, is out of providing it from some other spending component. I would ask the staff, is that their understanding of the parliamentary situation somebody would face on the floor?

Mr. Robertson. Mr. Chairman, if I can try to respond. My understanding of the fungibility rule, it only applies with respect to compliance with the reconciliation instruction to the Finance Committee. In other words, the bill reported by the committee under the Budget Act has what is known as the fungibility rule, so we can switch money from outlays to revenues, and vice versa.

Senator Conrad. Right.

Mr. Robertson. In order to ensure compliance with the reconciliation instruction to make sure that our bill is, in fact, deemed a reconciliation bill and not subject to points of order, the fungibility is allowed with respect to the committee mark, things that we do in the committee so that when we report the bill to the floor, those adjustments can be made so that we do not violate other Budget Act points of order.

The fungibility rules do not apply to things on the floor. Those are separate amendments. The normal Budget Act allocations would apply on the floor, and those are separate outlay and revenue totals.

The Chairman. Senator Breaux?

Senator Breaux. Mr. Chairman, I would like to just ask a question about a change in the Chairman's mark, then make a comment about, if I understand it correctly, an amendment that I would offer.

The Chairman. Senator Breaux, before you do that, Mr. Yin has not had a chance to explain the modification of the modification, so I would like to have him do that, then ask your question.

Senator Breaux. Sure. Absolutely.

The Chairman. Mr. Yin?

Mr. Yin. Thank you, Mr. Chairman.

The first item in the modification of the modification is to extend the dividends proposal through dividends paid by a foreign corporation other than a foreign corporation not traded on a securities market or a foreign investment company, a PFIC, and a foreign personal holding company.

The second item, is to clarify that the purposes of the $20 billion trust fund are to include additional measures to ensure that fiduciary attorney fee standards are adequately respected.

The third item, is to extend current law in permitting qualified transfers of excess pension assets to retiree health accounts.

The fourth item, is to treat property and casualty companies like life insurance companies with respect to the life insurance reserves of the PNC companies.

That completes the modification of the Chairman's modification.

Senator Breaux. Mr. Chairman?

The Chairman. Senator Breaux?

Senator Breaux. I have two questions. Number one, on the first modification, I think I agree with one of them and disagree with the other. On number A, partial exclusion of dividend income from tax. Does that address the question that you all heard me address this morning about U.S. citizens getting dividends from foreign-owned corporations?

I gave you the Shell example, that that would not get the benefit of the dividend reduction if the dividend came from a foreign-owned corporation, even though they were doing business, employing people, and paying taxes in the United States. Does this address that? Does this take care of the concern that I attempted to raise?

Mr. Yin. Yes, Senator, I believe so.

Senator Breaux. All right. I like that one then. I do not like, I think, the next one, which is Part B, which is a temporary State Fiscal Relief Fund, money going to the States.

There has been an addition which I think I understand, which says the purposes of this fund that would be created under this modification could include additional measures to ensure that fiduciary attorney fee standards are adequately respected. That is a very generic statement that could include a whole bunch of things that I think may cause a lot of problems.

One of them is, while I would like to fix the fees that my electrician gets or my plumber gets, but when they are negotiated between individuals, I do not think Congress has a reason to be involved in moving in to determine what are adequate fees when they are freely entered into to fix service fees, whether it is for lawyers, doctors, plumbers, electricians, or anything.

I am concerned that this language would then allow it, if it was adopted, to go to the floor with amendments to this language dealing with attorney's fees, which would be protected under the Budget Resolution and require 51 votes only to pass.

Would that be the understanding of counsel? If it passes, any amendment to this would come under the Budget Resolution protections, requiring only 51 votes.

Mr. Robertson. I think that is correct. In other words, whatever amendment we make to this, as long as we stay within the total reconciliation allocation, which is

$350 billion. So in other words, we can move money between revenues and outlays within a 20 percent range and we can move money from one year to the next, as long as we are within that projection.

Senator Breaux. I understand. I think your answer is my understanding.

Mr. Chairman, I think that this is an issue. If we are going to debate it, we ought to debate it in the Finance Committee. If someone wants to offer an amendment that tries to upset the way attorney's fees are provided in the tobacco settlement cases, they ought to make the point here in the committee, ought to vote on it in the committee. If you win, you win. If you lose, you lose.

But this seems to me to be a back-door approach to get this into the bill to somehow allow it to be handled on the floor and not being handled in the committee. I think I am going to have an amendment to strike that at the appropriate time.

The Chairman. Senator Breaux, could I ask, since you are one side of this and Senator Kyl is on the other, I wonder if you could offer that amendment right now to accommodate Senator Kyl.

Senator Breaux. Oh, sure. I would offer it, if that is appropriate, just so we can get to discussion.

I do not know if we have a drafted amendment, but the amendment would simply strike the Section B of the Chairman's modification, what you call 1B.

The Chairman. I am a little bit ahead of myself, but we are ready for you in 30 seconds.

Senator Bingaman. Mr. Chairman, could I ask a question before you go to amendments?

The Chairman. Now, wait a minute. We have got to adopt my modification.

Senator Bingaman. Mr. Chairman, could I ask one question before we vote on your modification?

The Chairman. Well, I hope you do not have to vote on it.

Senator Bingaman. No. Just to ask a question of the staff.

The Chairman. Yes, go ahead.

Senator Bingaman. Do we have an idea of what the modification of the modification is going to cost, what these different provisions you just described are going to cost? Do we have a score?

Mr. Yin. Senator Bingaman, do you want it on each of the items?

Senator Bingaman. Yes, that would be great.

Mr. Yin. All right. On 1A, the amount is $1 billion. All of these are over the budget window.

Senator Bingaman. Over the 10 years.

Mr. Yin. Over the 10 years. That is correct.

Senator Bingaman. One billion for 1A?

Mr. Yin. Yes. 1B is no effect. 2A is a revenue increase of $298 million and 2B is a revenue increase of $719 million.

Senator Conrad. Could you say that again, please?

Mr. Yin. Yes. Yes. The 1A, the revenue cost, is $1 billion over the 10-year period. 1B has no revenue effect. 2A raises revenues by $298 million over 10 years. 2B raises revenues by $719 million over the 10-year period.

Senator Bingaman. Thank you very much, Mr. Chairman.

The Chairman. All right.

Now I will move to modify the Chairman's mark, and without objection the Chairman's mark is modified.

Senator Breaux?

Senator Breaux. I have an amendment to that modification. It would be to strike out, under 1B, the last sentence that states, "The purpose of the fund could include additional measures to ensure that fiduciary attorney fee standards are adequately respected." I know this is sort of not legislation here. This is just sort of a statement. I want to get rid of that statement.

The Chairman. All right.

Then, Senator Kyl?

Senator Kyl. Thank you. I will oppose the amendment. First, I want to assure Senator Breaux that he is correct in his understanding about why the statement is there and what the possible impact of it is, but I would like to explain it, if I could.

One of the ways in which we wanted to consider helping States get more money was to take advantage of a phenomenon which is an outgrowth of the tobacco litigation and settlement thereof in which, through something called a master settlement agreement, all of the attorney's fees arrangements were combined into one master settlement agreement, as the name implies.

Out of that, fees are paid to the various lawyers who participated in the tobacco litigation. Among the provisions of that master agreement are that certain of the attorneys receive about $500 million a year in perpetuity.

The present value of that money is estimated to be approximately $8 or $9 billion. Since it is our contention that that is a breach of the fiduciary responsibility to the clients, the States in this case, by virtue of the excessive nature of the fees that resulted from that master settlement agreement, that was

money that would be returned directly to the States, i.e., the clients in this case.

The tobacco companies still have to pay it, but instead of the excess fees going to the attorneys, the excess fees would be returned to the States. I have a couple of sheets of paper which can indicate how much money would be available to each of your States.

By way of comparison, if you want to compare your State to the State of Arizona, with a little over 5 million people, the return to Arizona would be in the neighborhood of $164 million.

How might this occur? I point out, first of all, Senator Breaux, you are correct that there is no specific language here. This is a placeholder. It was designed to create an opportunity for us to write an appropriate provision so that money could be returned to the States as part of this bill before the bill got to the Senate floor.

I assure you, this is not a backdoor approach. I have been working on this some time. Senator Cornan and I have legislation introduced. This provision, as a matter of fact, was in the budget two years ago. The score on this did not come in until midnight last night.

It was impossible to rewrite it to reflect the issues that arose as a result of that. That is why we simply

put this in as a placeholder, and it was not our intention to deceive or backdoor anyone. I fully intended to discuss it with you.

Let me just explain a little bit further what the etiology of this is. In 1996, I believe it was, as a result of the sort of infamous case of Jim and Tammy Faye Bakker, Congress amended the IRS Code to provide that in certain situations where there was a fiduciary responsibility and the fiduciary had clearly taken advantage of the beneficiary, in this case of a trust, that the IRS had the authority to impose a tax on the difference between what was obviously reasonable and what was, in fact, taken.

In that case, allegedly, the trust was established and most of the money out of the trust went to the two trustees. That was clearly wrong.

So there are other situations in which, where there is a breach of fiduciary duty, this IRS Code provision kicks in. Essentially, it applies a confiscatory tax rate to the excess, the purpose being to get the individual to give the money back to the client, which is what they do, because obviously you do not want to pay the confiscatory rate.

So that same provision would apply to settlements exceeding $100 million in size, and it would, in fact,

apply to the tobacco master settlement agreement where it is alleged and could be proved that the fees exceed any reasonable standard under the interpretation of that IRS Code provision.

How much might that be? The standard that is used in court is called the Lode Star Standard. What this contemplates, is that the court would fix the fee as the Lode Star Standard, which is a very liberal standard, taking into account the difficulty of the case, the risk taken by the lawyers and the number of hours put in, and all of those factors, and then it would be 500 percent more than that.

So, the attorneys would be getting a reasonable attorney fee, as usually determined in court by this Lode Star Standard, plus 500 percent. Anything above that amount would be subject to this tax.

So, for example, in this settlement, attorneys are getting fees at roughly $150,000 an hour. Now, that is about the salary that we have on an annual basis, and there are a lot of folks that think we are paid too much money.

But think about, instead of an annual salary, if that is an hourly salary. That is the amount of money on an hourly basis. This is not a matter of contract. The law has always recognized, and the lawyers among us certainly

know, that no lawyer contract with a client can stipulate a fee that is unfair under the rules of ethics, that there is still a fiduciary responsibility not to over-charge the client, and those ethics principles apply over in a contractual arrangement. So, it is not the same as a plumber or an electrician.

So what we would like to do, is to craft a provision which would enable us to take advantage of this provision of the IRS Code and rebate to the States approximately $8 to $9 billion in revenue that is being paid by the tobacco companies.

There is more I could say, but that is the quick explanation of it.

Senator Bingaman. Mr. Chairman?

The Chairman. Senator Bingaman?

Senator Bingaman. Mr. Chairman, let me ask a question of Senator Kyl, if I could.

My recollection, when I was practicing law, was that the fee arrangement between the attorney and the client was always a subject for review by the court. Why are we feeling the obligation to step in and legislate where the court has presumably determined that the fee arrangement is a fair arrangement, and the two parties to the case presumably have determined that is a fair arrangement, or else they would be in court challenging it?

I mean, if the States think they have been abused here, they can certainly go before a judge and say, let us out of this agreement to pay as much as we are having to pay. Why do we have to be legislating something to interfere with what the courts have always done?

Senator Kyl. Mr. Chairman, Senator Bingaman, that is a very fair question. The answer gets into some of the intricacies of this settlement, which actually did not, except in one case that I know of, involve court approval of the contracts and of the fees.

The attorneys involved in this were very clever to avoid exactly that, because they did not want their fees reviewed. In most cases, you will find that you cannot find out how much the fees are because the information is not public, has not been, and presumably would not be made public.

Rather, what happened was, as a result of each of the different cases, like your State attorneys general bringing the case, that was all consolidated into this master agreement which applied to all of the States, as a result of which the tobacco money paid in is actually just like a tax.

It is paid out to the States essentially, as I understand it, on basically a per capita basis. By the way, that is exactly how these funds would be returned as

well, on a strictly per capita basis.

So the normal attorney/client contract for fees did not apply in this case. What was substituted instead was this master settlement agreement.

Now, the second question is still implied, which is, well, could States still go back and sue? The answer is, no. The way the agreement was crafted, the settlements that the States entered into, primarily through their attorneys general, do not provide for a challenging of the contract on attorneys' fees. So, in effect, the lawyers that did this were very clever. They avoided court review and they avoid further litigation.

The only way that the State could get the money back is to file the claim under a provision such a we offer here. Now, no State would have to do that, so it is strictly voluntary on the part of the States. We are not mandating anything.

All this provision would do, is to say that, in addition to the trust fiduciary responsibility, the IRS Code provision would also apply to this kind of attorney/client situation. It would be up to the clients, the States, to then avail themselves of that provision if they wanted to do so.

The Chairman. I will be glad to accommodate more discussion, but I am trying to accommodate, also, Senator

Graham and Senator Kerry that have other schedules. I will let you follow up.

Senator Bingaman. Let me just say that, hearing your description of it sounds to me like you have very little confidence in the ability of our attorneys general around the country to represent their States adequately.

Your view is, they entered into this agreement without really understanding it, and now we should come in and legislate some kind of federal preemption of the agreement that they entered into. I do not know.

I used to be attorney general in my State. I like to think that I would have done a better job for the State than you seem to imply the 50 attorneys general have done in this case.

Senator Kyl. Mr. Chairman, I will be very brief. Yes, I would like to imply that. You certainly would have, Senator Bingaman. Senator Cornan, as a matter of fact, who is the co-sponsor of this bill with me, actually got his predecessor indicted for this very thing.

The fact of the matter is, I do not blame the attorneys general. It was a very difficult situation. If they wanted the money, they had to go along, and I do not blame them one bit. This simply offers them the ability to review it, and if they decide they want to

apply for the money they would still have to file their claim, but we would be providing that ability.

Senator Breaux. Mr. Chairman, can I close?

The Chairman. Senator Kerry had to be before you, then I will let you close.

Senator Kerry. I will just take a minute, because I know Senator Graham needs to go. I am going to see if we can cooperate in that effort.

I would just say, very quickly, I know there is an unprecedented effort on the other side of the aisle in this institution to try to curb the capacity of attorneys to have access to courts, or even to remedy situations, and it is an ongoing effort.

But I am surprised by this one because it is unconstitutional. Its reach goes way beyond anything we have ever done before. We can do this to a private contract, which is essentially what you have.

We could come in and say to every airline, as we have seen recently, abuses, where a president pressured employees to take cuts and they hid their compensation. Are we now going to step in on every single business in America and suggest that executive compensation seems to be changed?

If you run through this, there are any number of constitutional problems with it, as well as an

unprecedented over-reach by the Federal Government into private transactions. I think, Mr. Chairman, it is extraordinary the degree to which it reaches beyond the appropriate sanctions, even of the Federal Government, in this kind of situation.

The Chairman. Senator Breaux, on closing remarks.

Senator Breaux. I would just close by saying that it is clear that, when cases are arbitrated and settled, the judge has to approve those settlements. Attorneys' fees are part of that.

In many cases, the many of the lawyers did not even have contingency agreements. They relied on the court to set reasonable attorney fees after the settlements were reached. It was a decision by the court as to what was fair.

In many cases, they set up panels and both sides selected members. Both the plaintiffs and the defendants set up panels to determine what were appropriate attorneys' fees. That is how they were arrived at.

It is simply, I think, very bad precedent for us to be deciding what are legitimate fees in any industry in this country. That is what the private sector does, and when there is disagreement, that is what the courts are for.

The Chairman. Would the Clerk please call the roll?

The Clerk. Mr. Hatch?

The Chairman. Mr. Hatch votes aye, by proxy.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. Present.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. No.

The Clerk. Mr. Frist?

The Chairman. No, by proxy.

The Clerk. Mr. Smith?

Senator Smith. Aye.

The Clerk. Mr. Bunning?

Senator Bunning. No.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Rockefeller. Aye.

The Clerk. Mr. Daschle?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Graham. Aye.

The Clerk. Mr. Jeffords?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Bingaman?

Senator Bingaman. Aye.

The Clerk. Mr. Kerry?

Senator Kerry. Aye.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. I vote no.

The Clerk. Mr. Chairman, the tally is 12 ayes, 8 nays, 1 present.

The Chairman. The amendment is adopted.

Senator Bingaman. You mean, the amendment was not adopted?

Senator Breaux. The amendment was adopted to take the language out.

Senator Bingaman. Oh, it was? Good. [Laughter].

Senator Breaux. We are together here.

Senator Bingaman. I was so shocked to see a Democratic amendment adopted, I just assumed you had misspoken, Mr. Chairman.

The Chairman. The amendment was adopted.

Senator Graham of Florida?

Senator Graham. Thank you very much, Mr. Chairman.

The Chairman. Would each person who has an amendment state the number of their amendment, if they have a number on it?

Senator Graham. Number one.

The Chairman. All right. Number one. Very appropriate. Go ahead.

Senator Graham. Mr. Chairman, first, I want to thank you and Senator Baucus for your courtesy in allowing me to go at this time. I will be brief, as I outlined the essence of my amendment in my opening statement.

This amendment has several objectives. One, is to provide for real stimulation during the period when stimulation is most necessary. This amendment provides that there will be significant tax relief for all Americans who pay the payroll tax, $765 this year, $765 next year.

It also provides for significant stimulation through

small businesses by increasing the amount that they can write off in one year from $25,000 to $100,000 for each of the next two years.

Second, it has significant assistance to the State. It can provide $40 billion of assistance to the States to assist them in a very difficult time, in a time when many States are about to contribute to the unemployment statistics by large numbers of persons losing their jobs.

It also, and I think particularly importantly, does not add to the national debt. It provides that there will be full coverage of all of the costs of this amendment. This amendment costs approximately $255 billion. There are $255 billion of offsets.

It would be irresponsible of us to be adding to the national deficit at a time when the deficit is already going to be a record high. We have costs associated with the war and post-war periods. I believe that, when we can avoid asking our grandchildren to pick up the cost of our action today, we should take advantage of that.

Finally, it provides for an extension of the unemployment benefits for those Americans who have run out of their State unemployment benefits and existing federal unemployment benefits.

Not only is this the right thing to do, but these are people who are in the highest category of those Americans

likely to use the dollars that will be made available to them to increase the demand and consumer capability of our Nation's economy.

The Chairman. Thank you, Senator Graham. I would like to speak against your amendment. First of all, I want to make it very clear to everybody that, as the economy has continued to remain soft as we have had a recent increase in unemployment, that it is very obvious to me that we are going to have to extend current law before it expires at the end of this month.

But I would like to point out that this amendment is very unprecedented, and I think an unjustified expansion of the unemployment program. I will explain that in an historical context.

Unemployment has not risen to the levels of previous recessions. In previous recessions, Congress has responded very appropriately to extending unemployment benefits when they were needed.

I would say that we now have current unemployment, as I said, of 6 percent. But this would compare to 7 percent in the 1990s and would compare to 8 percent, or even more than 8 percent, in the 1980s. These were the last two times that Congress provided extended benefits.

I think it is also very important to understand that, in at least 23 States, we have an unemployment rate that

is lower than it was a year ago. In regard to people that have exhausted their benefits, this amendment would provide 26 weeks of federal benefits without regard to the duration of State benefits.

It violates, then, the insurance principles inherent in the unemployment program by breaking the historic link between the time someone has worked and the time that a person can collect unemployment benefits.

This amendment would also allow someone who has worked as few as 20 weeks to collect as much as 26 weeks of federally funded benefits. Then in regard to part-time workers, States already have the option to do this. This provision would allow those seeking only part-time work to collect unemployment benefits. That means a worker could turn down a full-time job and continue collecting unemployment benefits.

Then in regard to low-wage workers, this is another option that States already have. This provision, then, in this amendment would require State to use alternative base period, that would be the most recent quarter, to calculate benefits. In 1997, the Senate voted 85 to 15 to overturn a federal court decision that would have required States to use most recent quarters.

So, I think that this amendment may be very well-intended, but at this point, compared to other points in

the history of higher unemployment, it goes much further than we ought to at this particular time.

Is there any other discussion? Senator Rockefeller?

Senator Rockefeller. Just a brief comment, Mr. Chairman. This amendment strikes me as a good amendment. I think real stimulus is important. I think it provides it. We have got the wage credit, expensing small business. It has the FMAP, which obviously I am involved in in a lot of other things. I think it is a good amendment.

The Chairman. The Senator from Oklahoma.

Senator Nickles. Mr. Chairman, I would just ask my colleague from Florida, how much does the refundable wage credit for 2003 and 2004 cost?

Senator Graham. The refundable wage credit?

Senator Nickles. We are writing checks, so I am just wondering how much those checks are.

Senator Graham. Yes. It is $100 billion for this year and for next year, for a 24-month period.

Senator Nickles. Is it $100 billion each year or $100 billion combined?

Senator Graham. It is $100 billion in the first 12 months, and then another $100 billion in the next 12 months.

Senator Nickles. So it costs $200 billion.

Senator Graham. The reason is, this straddles fiscal years.

Senator Nickles. I understand.

Mr. Chairman, let me just say, I think this would be a very irresponsible amendment. I am afraid it would kill Social Security, that 7.65 percent. It basically says, do not pay Social Security tax on the first $10,000 of income. I do not know how you make that up to Social Security funds.

Not that I am a worshipper of Social Security trust funds, but you would be taking that portion of the base. I guess the employers still have to pay Social Security funds, but individuals would not. As a matter of fact, we would pay them back at a cost of $200 billion over two years.

The title of the amendment says "fiscally responsible," but it costs $200 billion in outlays just for that one provision, then $40 billion in one year to State Aid. I might mention, the budget that we just passed says that growth in outlays, non-defense, are $10 billion. This says, let us go ahead and spend $40 billion in one year.

The amendment that is contemplated by the Chairman is $20 billion over two, or $10 billion per year. This is four times that amount for the first year alone, on an

annual basis. So, I would urge our colleagues to not support this amendment.

The Chairman. All right. Could we have a voice vote on this?

Senator Graham. Mr. Chairman, before we do, I would like to reserve the right to close.

The Chairman. All right. Then I will call on Senator Kerry.

Senator Kerry. Well, I support what Senator Graham is trying to do. It is very similar, in fact, to what Senator Nickles has described in terms of the payroll tax.

In fact, over in the budget debate, I proposed a payroll tax holiday which, as the Senator knows, can be credited in a way that it does not come out of Social Security, it comes out of general revenues. So, there is absolutely zero threat in this to Social Security, number one.

Senator Nickles. Is that in the Senator's amendment?

Senator Kerry. That is clear in the Senator's amendment.

Senator Nickles. General revenues to pay Social Security?

Senator Kerry. It comes out of the general revenue.

It is credit. It does not come out of Social Security. But, may I add, every dime of the Republican proposal is against Social Security. Every dime of it.

I mean, what kind of sophistry is this where you sit there and say, gee, we are trying to protect Social Security when about $1.3 trillion has already been taken out of Social Security in the last year and a half?

So, I think the Senator from Florida has what is equivalent to a $10,000 payroll tax holiday, but he has framed it differently. The fact is, it is extraordinarily helpful in terms of putting people to work now.

The Chairman. Senator Bob Graham?

Senator Graham. Thank you, Mr. Chairman.

First, let me just briefly respond to some of the questions that have been raised.

Senator Conrad. Could I ask the Chairman to get order? There are a lot of conversations of staff going on behind us and it makes it difficult to hear the Senators.

The Chairman. Yes. I think the audience has been very quiet, but maybe staff has not been.

Senator Nickles. The audience is asleep. [Laughter].

The Chairman. Then could I say, like the president

pro tem of the Senate says, would the members take their conversations outside the room and go with your conversations? [Laughter].

Senator Bob Graham, you can start over again.

Senator Graham. Yes. Thank you, Mr. Chairman.

Let me, first, comment on some of the issues that have been raised. As to the unemployment extension, the 26 weeks is what was provided during the last recession. The part-time and low-income provisions are optional, not mandatory, on the States.

Frankly, Mr. Chairman, we are here in order to stimulate the economy, and I think particularly stimulate the economy on the demand side, so we should be looking to those Americans that are the most likely to spend whatever resources are made available.

I think, clearly, those people who have lost their jobs and run through their State and federal unemployment benefit are a very high category to do precisely what we want, which is to stimulate the economy and to create jobs.

Insofar as Senator Nickles' concern, this is an income tax credit. The Social Security and the Medicare programs will be held harmless. That is where the $200 billion comes from in order to assure that there is no denigration of the Social Security and Medicare trust

funds.

But, frankly, those are significant, but not the major issues. The major issue, in my judgment, is do we want to provide the maximum benefit to those persons who are the most likely to spend it?

I believe that a $765 annual tax credit for each of the next two years will have a significant stimulus effect, as well as the acceleration of depreciation for small businesses. This is fully paid for.

We are not going to be asking Americans of our children and grandchildren's generation to be picking up the cost that we are unwilling to do. We are going to get the principal benefit out of this if it achieves its purpose, which is a jump-start to the economy.

Why should we not pay for this benefit as opposed to putting it as an additional layer on an already irresponsible pile of federal debt and deficit?

So, Mr. Chairman, joined by Senator Rockefeller and Senator Kerry, I urge the adoption of this amendment.

The Chairman. Yes. Now, what I would like to assume is we can have a voice vote, unless a member says they want a roll call.

Senator Graham. I would like a roll call.

The Chairman. Would the Clerk call the roll?

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.
The Clerk. Mr. Nickles?
Senator Nickles. No.
The Clerk. Mr. Lott?
Senator Lott. No.
The Clerk. Ms. Snowe?
Senator Snowe. No.
The Clerk. Mr. Kyl?
The Chairman. No, by proxy.
The Clerk. Mr. Thomas?
Senator Thomas. No.
The Clerk. Mr. Santorum?
Senator Santorum. No.
The Clerk. Mr. Frist?
The Chairman. No, by proxy.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. No.
The Clerk. Mr. Baucus?
Senator Baucus. No.
The Clerk. Mr. Rockefeller?
Senator Rockefeller. Aye.
The Clerk. Mr. Daschle?
Senator Baucus. Aye, by proxy.

The Clerk. Mr. Breaux?

Senator Baucus. He passes.

The Clerk. Mr. Conrad?

Senator Conrad. No.

The Clerk. Mr. Graham?

Senator Graham. Aye.

The Clerk. Mr. Jeffords?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Bingaman?

Senator Bingaman. Aye.

The Clerk. Mr. Kerry?

Senator Kerry. Aye.

The Clerk. Mrs. Lincoln?

Senator Baucus. No, by proxy.

The Clerk. Mr. Chairman?

The Chairman. No.

Anybody that has not voted and wants to vote?

Senator Breaux. Aye.

The Chairman. There is another Senator. Senator Breaux wants to vote.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Chairman, the tally is 7 ayes, 14 nays.

The Chairman. Based on that vote, accordingly, the

amendment is defeated.

We are going to divert just for a minute for Senator Kerry to make an opening statement, because he did not have the opportunity this morning.

Senator Kerry?

OPENING STATEMENT OF HON. JOHN F. KERRY, A U.S. SENATOR FROM MASSACHUSETTS

Senator Kerry. Mr. Chairman, thank you very much. I appreciate that. I will not be that long.

I recognize that I fall into a category where almost anything I say is going to be immediately put into a context. I wish that were otherwise, because in the 18 years that I have been here, I really have never seen what I consider to be as significant a departure from an economic reality, a set of baseline realities, as this tax package that the Finance Committee is going to vote on today.

I know Senator Conrad made a fine presentation this morning with charts that show what happens to deficits, where we are headed. Senator Rockefeller, Senator Baucus, and others have all spoken very effectively to what is happening here.

This is an extraordinary sort of ideological divide, I guess. It is a gridlocked divide and it is one that we are going to pay an enormous price for in the long run. If we were really trying to just help the economy and create jobs, there are an extraordinary number of smart people in this country who are in the private sector, as well as those who make a practice of studying economics,

as well as those who teach, who would all say there are better ways to put people to work, there are more guaranteed ways to put people to work, there are more effective ways to deal with tax cuts and distribute them in a more fair and equitable manner.

There are a couple of good portions of this that many of us support, certainly fixing the marriage penalty, certainly the child credit. Those are important objectives for our country.

But it is really hard, under almost any rationale, to explain what is such an important objective in the face of Medicare cuts, hospitals under stress, people without health care, schools that are laying off teachers, baby boomers about to retire, rebuilding costs of Iraq that we do not even know how much, the largest budget deficits in history.

What is so compelling about an accelerated upper income tax cut where we are giving 54 percent of all the benefits of this tax package to people who earn more than $315,000? The theory is, they are going to reinvest it and start jobs, the old trickle-down, same old theory we heard with President Reagan, the same old theory we hard from President Bush a year ago.

Well, President Bush, as we know, originally sought a $726 billion package. That has been reduced now, thanks

to common sense. I do not want to condemn a couple of Republican colleagues by praising them, but that common sense and strength brought that number down.

Last year, we passed a $1.35 trillion tax cut. That does not include another $600 billion or so of tax cuts that appeared in the President's budget. So, in less than three years, the President has proposed nearly $3 trillion in tax cuts over the next 13 years.

I should point out that more than half of this, $1.63 trillion, was proposed this year after the budget had already returned to perpetual deficits. Adding interest, the total jumps to $3.8 trillion.

Now, the President promised not to spend Social Security funds. That was his promise, those are not our words. He promised that, but his budget spends Social Security every single year.

Leaving that aside, the President has also promised that his slightly reduced tax cut request is now going to create one million jobs by the end of next year. Well, it is very hard to understand how that will work when his $1.3 trillion tax cut of last year wound up with a net $2 million plus jobs lost.

The Federal Government is running historic deficits, and as we know, the States are in an enormous budget deficit. Now, what I find intriguing, is that in the

modification that the Chairman just put before us there is a Temporary State Fiscal Relief Fund that establishes a fund of $20 billion, in which it is acknowledged that education and job training, health care services, Medicaid, transportation, other infrastructure, law enforcement, public safety, other essential government services, are worthy of being tokenly noted.

We are going to give them $20 billion, recognizing those are important priorities for the country, but we are not going to give them the $80 billion that they are hurting, we are not going to give them $70 billion, $60 billion, $50 billion. We are going to find it more important to give people earning $315,000 a year another tax cut.

Now, if you calculate that, Mr. Chairman, if you accept the President's estimate, his proposal will cost $154 billion in 2003 and 2004, which amounts to $154,000 of lost revenue for each job that he promises will be created. That is more than three times the average salary in this country, per job, that he promises. That is an extraordinary inefficient use of resources.

In addition, the President's plan allocates only 10 percent of all of the tax spending to immediate job creation. Here we are with an economy in the doldrums, 6 percent unemployment, it has gone up, countless numbers

of Americans fearful about the economy, lacking confidence in it, and the most money, 90 percent, goes to future tax cuts. Common sense Americans know that tax cuts in 2005 and 2006 are not going to create jobs today.

These tax cuts, Mr. Chairman, are indiscriminate. They are not tied to economic growth. We obviously hope they will have some positive result, but it is hard to rationalize how a tax distribution on the accelerated upper income tax rate, the bottom 60 percent of taxpayers, the majority of Americans, will get less than 1 percent of the benefits of this tax cut.

I hope America hears that. One percent of the benefits of this tax cut will go to 60 percent of the bottom end of income earners in America. The top 20 percent of income earners will get 94 percent of this tax cut and 54 percent of this tax cut will go to people earning more than $315,000 a year.

If that is not an extraordinary statement of priorities about our country, when Teachers of the Year are being laid off in South Carolina, when people across this country are struggling to pay health care, when they do not have benefits, when Medicaid is going to be reduced for children in States all across the country, I do not know what is.

I think this is a rather extraordinary political

document and I think the United States is going to pay a high price for it in the years to come.

Thank you, Mr. Chairman.

The Chairman. Thank you, Senator Kerry.

Before Senator Baucus asks his question, we have one member on my side of the aisle, and I think we have a couple on the other side of the aisle, who wanted to leave at a certain time, maybe about an hour from now.

I am wondering if we would be able to accommodate those members, because obviously we cannot lose anybody if they want to vote, because proxies do not count towards reporting a bill out under the rules.

So, Senator Baucus, would you please proceed?

Senator Baucus. Yes. Thank you, Mr. Chairman.

Mr. Chairman, I have an amendment.

The Chairman. Yes.

Senator Baucus. I ask that it be modified. My amendment is Amendment Number 3, and I would like the modification.

The Chairman. And the amendment is, accordingly, modified.

Senator Baucus. The modification is, instead of eliminating the tax on the first $6,000 of wages, it would be $5,000. There would also be a similar reduction for married couples. That is, instead of $1,200 for

married couples, it would be $1,000.

Mr. Chairman, the modification is to accommodate a change in the revenue estimate that is the cost of the dividend provision. My amendment would be offset by the current dividend provisions contained in the mark, and that is about $80 billion.

The whole point here, clearly, is to help shift this bill in a way that stimulates the economy more quickly. I did a little calculation, Mr. Chairman, on the mark-up here, on the sheet.

Only 8 percent of the total cost of this bill will be spent in 2003, and 50 percent will be spent in the year 2006, and later. So, this is not a bill which stimulates the economy very quickly at all.

Again, 8 percent in 2003, and 22 percent of the bill in 2004, 18 percent in 2005, and that is about 50 percent. The other 50 percent is in subsequent years. I just do not think that is right.

If the goal here is to stimulate the economy, more dollars should be spent up front rather than back. It should not be back-loaded. This amendment basically accomplishes that objective by providing a 10 percent credit on the first $5,000 of wages as wage income.

The second goal here, frankly, is to give relief to people who need it, wage earners, people who work for a

living. The point here is, with a $5,000 credit on wages for single persons and $1,000 for married couples on wage income, that is going to help those who work get a little bit of relief, because they desperately need it.

Another point here, too, is these are the people who are going to spend the money. Clearly, wage earners, particularly at the lower end of the wage salary scale, are more likely to spend dollars that they get in tax relief than are upper income people. I do not think anybody disputes that. Nobody disputes that.

Really, the question comes down to values. What are our values here? As we work to stimulate the economy, do we want to help those people who need the help, that is, wage earners? Do we want to, on the other hand, help people who do not need tax relief?

Another value is, are we going to be honest with what we say? We say here we want a jobs and growth bill. We want to help people who are currently out of jobs, we say. By we, I mean most members of Congress, including the White House.

We say we want to stimulate the economy, and yet the tax bill before us does not do that. The tax bill before us provides a very small percentage, 8 percent, is spent in calendar 2003, and 50 percent is spent in years 2005 and afterwards.

The amendment also provides that for those 80 percent of Americans that, frankly, pay more in payroll taxes than they do in income taxes. Eighty percent of American people pay more in payroll taxes than they do in income taxes.

So, this amendment also provides for a check of up to $500 for those people who do not pay any income taxes, but who do pay payroll taxes. It just seems to me that those are the people who are going to spend the money, those who certainly work hard for a living, who work, and who have bills to pay. So, I just think this is eminently fair.

Again, it provides a 10 percent credit on the first $500,000 of wages that amount to a $500 tax savings for single persons, and it would be a 10 percent credit on the first $1,000 of wages for a married couple which provide for a comparable benefit for them.

I would ask that this be adopted. I think it is where the American people are, if you were to ask them. I think it makes eminent sense, and I hope we get support.

The Chairman. I would speak against the amendment. I know it is open to honest debate between two people or two parties about how this mark is crafted, but I want to make sure that everybody understands, we attempt to

strike a very good balance between consumption and investment incentives such that we can provide both short-term economic stimulus and building blocks for meaningful future economic growth.

Although, on the face of the provision before us it appears that this would benefit lower income taxpayers, the provision provides a rate holiday to everyone regardless of their income. In my view, this would upset the balance of the package that we have attempted to achieve between consumption and investment.

The proposal, as crafted, as a refundable income tax credit would be duplicative of the Earned Income Tax Credit, whose purpose and design was to refund payroll taxes for those who had insufficient income to have tax liability.

Temporary tax credits significantly drain resources, as they are expensive to implement and administer for short periods of time. So, I would ask that we would vote against the amendment.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. Just a question to the sponsor. Is this a substitute to the Chairman's mark?

Senator Baucus. No, it is an amendment.

Senator Nickles. It is an amendment. So you are

keeping everything else in the Chairman's mark.

Senator Baucus. Right.

Senator Nickles. You are just saying, let us add to the Chairman's mark no tax, income tax or Social Security and Medicare tax, on the first $5,000?

Senator Baucus. No, we are just striking the dividend provision and using that revenue to provide for a 10 percent credit on the first $5,000.

Senator Nickles. So you are keeping everything in the Chairman's mark except for the dividend.

Senator Baucus. Correct.

Senator Nickles. So you are taking that money, which is $80 billion. How much does your provision cost on this $500?

Senator Baucus. Eighty billion dollars.

Senator Nickles. It just happens to cost $80 billion.

A lot of people do not pay taxes, so we would write them a check. They do not pay income taxes.

Senator Baucus. Those who are working and pay payroll taxes would qualify.

Senator Nickles. So we would write them a check just for those payroll taxes, or for more than that?

Senator Baucus. No. They get up to a $500 check, depending upon their income.

Senator Nickles. On the taxes that they have paid.

Senator Baucus. Correct, yes.

Senator Nickles. Now, you have some individuals that make $14,000 that get an Earned Income Tax Credit of $4,200. Are we going to give them an additional $500 on top of that?

Senator Baucus. As you are implying, different taxpayers are at a different income level before they start paying income tax. I am trying to find the chart here.

Senator Nickles. An individual has to have income above $7,800 before they pay income tax.

Senator Baucus. No, that is not correct. A gross level at which a taxpayer has income liability, for a single with no children, is $9,000. Then it goes up to $30,000 if a taxpayer is married and has two children.

Senator Nickles. I am ready to vote on it.

Senator Baucus. But the specific answer to your question is, yes, a person could get both. Frankly, I think that is a good idea because those are the people that need the help and will spend the dollars.

The Chairman. Do you want a roll call vote?

Senator Baucus. I do.

The Chairman. Would the Clerk call the roll?

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.
The Clerk. Mr. Nickles?
Senator Nickles. No.
The Clerk. Mr. Lott?
The Chairman. No, by proxy.
The Clerk. Ms. Snowe?
Senator Snowe. No.
The Clerk. Mr. Kyl?
The Chairman. No, by proxy.
The Clerk. Mr. Thomas?
The Chairman. No, by proxy.
The Clerk. Mr. Santorum?
Senator Santorum. No.
The Clerk. Mr. Frist?
The Chairman. No, by proxy.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. No.
The Clerk. Mr. Baucus?
Senator Baucus. Aye.
The Clerk. Mr. Rockefeller?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Daschle?
Senator Baucus. Aye, by proxy.

The Clerk. Mr. Breaux?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Conrad?
Senator Conrad. Aye.
The Clerk. Mr. Graham?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Jeffords?
Senator Jeffords. Aye.
The Clerk. Mr. Bingaman?
Senator Bingaman. Aye.
The Clerk. Mr. Kerry?
Senator Baucus. Aye, by proxy.
The Clerk. Mrs. Lincoln?
Senator Lincoln. Aye.
The Clerk. Mr. Chairman?
The Chairman. No.
The Clerk. Mr. Chairman, the tally is 10 ayes, 11 nays.
The Chairman. The amendment is defeated.
Senator Conrad. Mr. Chairman?
The Chairman. Senator Conrad, for an amendment?
Senator Conrad. Yes.
The Chairman. Yes?
Senator Conrad. I would like to bring up my Amendment Number 4.

The Chairman. I had previously promised Senator Santorum.

Senator Santorum?

Senator Santorum. Thank you, Mr. Chairman.

Mr. Chairman, I have an amendment that I filed, Amendment Number 1, having to do with dividend parity for variable annuities.

As we have discussed on several occasions in putting together this legislation, there is a concern that I have, and I know a number of members on our side have, with respect to the treatment of variable annuities under the dividend provision that is in the Chairman's mark, and frankly, not just in the Chairman's mark, but also in the President's package, and the fact that the pass-through that is given to mutual funds is not also given to annuities because the annuities are based on underlying equities.

The concern is that we are now changing the balance between annuities, mutual funds, and other investment vehicles, to the disadvantage of those variable annuities.

So, I would say to the Chairman, we have had a difficult time, candidly, in trying to craft an amendment, given the fact that this dividend proposal is new. We have not been able to get a score on what this

amendment would cost.

I do want to alert the Chairman that there is no one who is a stronger supporter of the President's dividend proposal than I am, and I think the Chairman knows that. But I do believe that we should not be changing the balance between investment vehicles, retirement vehicles in particular, as a result of instituting this change.

So, I wanted to talk about this amendment. I will not offer this amendment because I am, frankly, not comfortable that I know how much it costs and would not know what a pay-for would be for it. But I am hopeful that, as we proceed forward, Mr. Chairman, that we take this consideration in mind.

I think this has a lot of support on our side of the aisle, and potentially even some on the other side of the aisle have some concerns about the dividend treatment to variable annuities.

I would hope that, as we move forward toward final passage in the Senate, that we can deal with this issue in a way that does not cause a discrepancy in the tax treatment for dividends to variable annuities.

The Chairman. I think, Senator Santorum, that this is an issue that has been brought up to me, not only from people outside of my State, but also within my State. Obviously, the more that is done in the area of

dividends, the more that this is an issue.

I would not say it is not an issue right now at the level we are, but obviously the more that is done, the more it is an issue. So, I think it is something that I am willing to work with you on. I have not formulated an exact position on it yet, but I think we can surely be open to discussion.

Senator Nickles. Mr. Chairman?

The Chairman. Yes, Senator?

Senator Nickles. I think Senator Santorum is raising a valid point. If we move towards eliminating the double tax on dividends, we do not want to put annuities at a disadvantage.

I do not think we do that in the mark that we have before us, but hopefully if we make some improvements on dividend policy, we will not disadvantage annuities in the process.

Senator Santorum. Mr. Chairman, I would just say, having looked at even this mark, I believe even this mark creates a disadvantage. Not as much, because the rates are much lower. But, nevertheless, I think it sets a precedent that is a harmful one, and I would hope that we would be able to remedy that in any future dividend proposal.

The Chairman. I would call on Senator Conrad.

I am going to ask Senator Nickles, just for three or four minutes, to Chair and respond to your amendment. I have to step out just for a minute.

Senator Conrad, go ahead.

Senator Conrad. I thank the Chairman.

I would like to say to the Senator from Pennsylvania, I think he raises a good point. I would be interested, if he gets an estimate of what the cost would be.

I think he is also right that the greater concern on this specific proposal is the precedent it sets. We do not want to have a divergence here between investment vehicles. That would be an unfortunate, unintended consequence. So, I think he raises a good point.

I would say to my colleagues, on the child tax credit--this is my Amendment Number 4, Mr. Chairman, Senator Nickles. The child tax credit has proven to be an effective means of providing relief to families with children. The mark before us would increase the child credit from $600 to $1,000, going back to the beginning of 2003.

My amendment would simply take it back to 2002. The assumption in the Chairman's mark is that providing $400 to families for the child care credit would be productive stimulus. My amendment agrees with that and suggests that going to $800 would be even better.

I would offset fully the cost of my amendment by delaying the effective date for the rate reduction for the top marginal rate. Based on the information from the Internal Revenue Service, it appears the cost of my amendment would be $15 billion.

Thus, the top rate reduction would be delayed until sometime next year. We would have to have that calculation made as to when next year. But instead of having it effective this year, it would be effective next year.

That strikes me as a reasonable sacrifice for the fewer than 1 percent of taxpayers in the top bracket to be able to provide much-needed relief to the nearly $27 million families with children who can use it in a way that is very likely to provide significant stimulus to the economy. We have asked economists to review this.

They said they think getting money into the hands of people who will use it will provide more lift to the economy in the short term. This would simply delay the top rate, the additional tax reduction scheduled for them, from this year into next year in order to provide for a full offset.

So, very simply, we go from $600 in the child tax credit to $1,000. Instead of going back to just the first of this year, we would go back to next year.

Again, it is fully offset in the way I have described.

Can we just adopt the amendment now, Mr. Chairman?

Senator Conrad. We could, but we will not. [Laughter]. I appreciate my colleague's amendment, and I believe I understand it. But let me just make a couple of comments.

I think Senator Kerry alluded to the fact that, well, he thought that this was weighted very heavily towards upper income and did very little for low income. I disagree.

Looking at the Chairman's mark, and I just want to make a couple of statements that I believe are very factual, under the Chairman's mark he accelerates the 10 percent bracket. That benefits low-income people. That costs $44.7 billion.

He accelerates the child credit to $1,000. That costs $89.8 billion. That benefits families. I would say predominantly the majority of that money benefits middle- and lower-income families.

You had $45 billion on the 10 percent bracket, the marriage penalty, which is $51 billion. The marriage penalty, under the Chairman's bracket, is basically expanding the 15 percent bracket for couples. That is going to save couples about $1,200 if they have income, I believe, up to about $54,000.

So, I just totally disagree with Senator Kerry's statement. That provision is $51 billion. So if you add those three provisions alone, you are talking about, I believe, $186 billion. That is well over a majority of this package that is very pro-family, low-income, middle-income, that are receiving the majority of this benefit. So how someone could say, well, the majority of this is going just to the 1 percent is not factual.

I think the majority of this is directed, under the Chairman's mark, maybe more so than what I would have preferred, and is weighted very heavily towards middle income that are going to benefit from the reduction of the marriage penalty, benefit from the child credit, benefit from the expansion of the 10 percent bracket, many of which will benefit also from the reduction in the brackets in lower rates from 27, to 25, and so on.

So, I just wanted to make those points, that I think some of the language is not accurate compared to what is actually in the Chairman's mark.

Concerning my colleague's amendment from North Dakota, with great respect, I would urge our colleagues to vote no on the amendment.

Senator Conrad. Mr. Chairman?

The Chairman. Senator Conrad?

Senator Conrad. Mr. Chairman, I thought for a while

there my colleague from Oklahoma was speaking in favor of my amendment.

What he describes as strong points of the Chairman's mark would be enhanced by the amendment that I have offered my colleagues to expand the child credit, to increase it from $600 to $1,000, and instead of making it just apply to 2003, make it apply to 2002, and fully offset it by asking those at the very top of the income ladder to delay their additional tax reduction until next year.

This would provide, in effect, and would shift $15 billion from those at the very top end of the income ladder to 27 million American families and give them additional child care credit.

If there was ever a family-friendly amendment, this is it. I would hope my colleagues would support it. I think a significant majority of those at the top end of the income category would be willing to delay their additional tax reduction in order to provide this additional benefit to 27 million American families.

The Chairman. Would you like a roll call vote?

Senator Conrad. I would, please.

The Chairman. The Clerk will call the roll.

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.

The Clerk. Mr. Nickles?
Senator Nickles. No.
The Clerk. Mr. Lott?
The Chairman. No, by proxy.
The Clerk. Ms. Snowe?
Senator Snowe. No.
The Clerk. Mr. Kyl?
The Chairman. No, by proxy.
The Clerk. Mr. Thomas?
Senator Thomas. No.
The Clerk. Mr. Santorum?
Senator Santorum. No.
The Clerk. Mr. Frist?
The Chairman. No, by proxy.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. No.
The Clerk. Mr. Baucus?
Senator Baucus. Aye.
The Clerk. Mr. Rockefeller?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Daschle?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Bingaman. Aye.

The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 10 ayes, 11 nays.

The Chairman. Accordingly, the amendment is defeated.

I would like to put out a proposition for members to consider. If there is no opposition among the people that are here, although there could be opposition among people who are not here, I would like to have a final vote at 4:30 on the package, and then continue, if there are other amendments after that, and make a commitment to

everybody who still wants to offer amendments, that at least from my side, I will commit that enough Republicans will stay here to give honest consideration to those amendments.

Would there be any objection among the people who are here that, in the tradition of the committee sometimes, maybe, that we would vote, subject to consideration of additional amendments after final passage? That accommodates some members on both sides of the aisle.

Senator Lincoln. Mr. Chairman?

The Chairman. Yes?

Senator Lincoln. Reserving the right to object, does this mean that everybody has predetermined exactly what they think on the amendments that we would like to debate honestly about things that are really important?

The Chairman. If those amendments were adopted, they would become a part of the bill, just like the bill was voted on after those amendments were adopted. That is the tradition of this committee. If there is any objection, I am not going to do it.

Senator Baucus. Mr. Chairman?

The Chairman. This is too important of a bill.

Senator Lincoln. I agree with that.

The Chairman. On a bill less significant, I might push the point.

Senator Baucus. Mr. Chairman, I am reluctant to agree.

The Chairman. Then that is the end of it. That is all right.

Senator Baucus. It is a dangerous precedent, to start setting deadlines that are creeping up earlier, and earlier, and earlier, and particularly when there are going to be amendments which, A) Senators feel very strongly about, and B) perish the thought, might have a chance of winning.

The Chairman. All right. Then we will proceed.

Now, I would like, before I take up the next amendment, we have this issue that has been around on the so-called placeholder for the State Aid.

So I would call upon our staff, Steve Robertson, to make a statement on that point. I think it is very important to Mr. Rockefeller, even though he may not be here to hear it, that this statement be made.

So, would you proceed, Steve?

Mr. Robertson. Thank you. We just want to make a clarification with respect to the modification of the Chairman's modification, and that is on the Temporary State Fiscal Relief Fund.

We had a discussion earlier today with the parliamentarian, and based on those discussions we have

modified the original Fiscal Relief Fund. I will just read the language. I think we will have copies made available, if they have not already been.

But essentially it says, "Establish a fund to provider $20 billion, divided among State and local governments, to be used for education or job training, health care services, transportation or other infrastructure, law enforcement or public safety, and other essential services.

In addition, a portion of the total amount shall be transferred to the Secretary of Health and Human Services to increase payments to States under Title 19 of the Social Security Act."

For those who are not completely familiar, Title 19 is a reference to Medicaid. We believe, with this modification, that we can meet the concerns that have been raised earlier today.

This will then serve as the placeholder, so that when we get to the floor, further amendments with respect to FMAP or other Medicaid would then be germane to the underlying bill.

The Chairman. All right. Thank you.

Now I call on Senator Jeffords for an amendment.

Senator Jeffords. Thank you, Mr. Chairman.

I have an amendment which I hope we all can agree

upon. As you may remember, back in the 1970s we ran across this little thing called marriage penalties. In the 2001 bill, we tried to correct the marriage penalty situation, and we did a very good job, with one exception.

The mark includes acceleration of two marriage penalty relief provisions from the 2001 tax bill, but leaves one out. Acceleration of the marriage penalty relief adjustment for low-income taxpayers who claim the Earned Income Tax Credit is left out.

The EITC provides for an income supplement for low- and moderate-income workers. However, the way the EITC is structured may result in high marriage penalties for families that claim the EITC.

For example, a man and a woman each with $15,000 in income and one child would each get a $2,754 EITC benefit if they were single, a total of $5,508. If they get married, however, their combined EITC would be reduced to $1,203, due to the phase-out of the EITC benefits.

This is a marriage penalty of $4,305, or 14.3 percent of their combined income. So, you have a huge barrier there for poor people who are workers to get married. Provision of the 2001 tax cut addressed this marriage penalty, but this provision is phased in gradually and does not become fully effective until 2008.

Acceleration of this phase-in will benefit working families with incomes between about $15,000 and $37,000. Most families in this income range would have seen their income tax credits rise by about $300 or $400. If we are going to accelerate the marriage penalty relief, we should do it for the poorest of the poor. These people really feel the effects of the marriage penalty.

These increases would have probably provided the most effective economic stimulus of any of the marriage penalty relief provisions because they are targeted towards the low- and middle-income workers who are likely to spend additional funds and stimulate the economy.

For pay-fors, I understand that accelerating the EITC marriage penalty amendment will cost an estimated $4.1 billion. I propose two pay-fors. First, I propose to modify the effective date for the proposed repeal of Section 911 in the Chairman's modified mark. This is effective January, 2005.

I propose to move this forward one year, to 2004. If this is a loophole, we should close it now. I understand that this would raise roughly $3.96 billion, and I am hopeful that somehow we can find a little amount up there somewhere.

The Chairman. The Senator is to be complemented on his pay-for, but I still must oppose the amendment. I

know that Senator Jeffords has had a very long-time concern about the Earned Income Tax Credit, and it is very much to Senator Jeffords' credit that the bill two years ago was expanded to include the Earned Income Tax Credit program, particularly in regard to married couples.

Now, in the mark that I have before you, the largest item is $89 billion for the child tax credit. Of that, $27 billion is going to families that pay no income tax. These are families that also benefit from the Earned Income Tax Credit.

In addition, the mark includes the President's proposal to send immediate checks of up to $400 per child, and for those who receive less than $400 in child credit, the check will match the amount of credit that they received in the 2002 rebate.

Those checks will go out this summer, if we get this legislation passed. Thus, it seems to me that working families are the first to receive benefits from the President's proposal.

I know that this is important to Senator Jeffords, but I believe that we have done a good job of trying to balance priorities in the bill and I look forward to the opportunity to work with him on EITC matters in the future, but unfortunately cannot at this time.

Senator Thomas?

Senator Thomas. Mr. Chairman, I, too, must oppose this amendment. I think we have to keep in mind what we are seeking to do here. We are seeking to try and stimulate the economy. Handing out money, we did that a couple of years ago, and all of you have commented as to how ineffective that was, yet you continue to want to do it. I do not understand that.

We need to do some things that cause people to create jobs. That is what we were are trying to do here. To send money out to people that do not pay taxes does not seem to me to be the way to do it. Furthermore, the President, in his program, has accommodated that need and is willing to send some things out there.

So I just wish we could focus on what it is we want the results to be. I know there are lots of things everyone would like to change in taxes, tax policy, all those sorts of things. But we are talking here about seeking to create jobs. I think we ought to focus entirely on what we can do there. So, I do not believe this amendment would be favorable.

The Chairman. Senator Breaux?

Senator Breaux. If I could just make a comment on it. Mr. Chairman, the Jeffords amendment, I think, makes a great deal of sense, but my concern is the offset that

we use to pay for it.

I mean, in my State of Louisiana, almost 30 percent of all of the taxpayers are Earned Income Tax Credit recipients. I think the only other State that has a higher percentage is actually Mississippi.

So when we do something for people who are facing a marriage penalty in a Tax Code, what this bill does, it does it for everybody else except them. I mean, we are giving marriage penalty relief for everybody in the Tax Code that happens to be married, except if you are a poor married couple.

You can argue, well, they get breaks in other things that we do. That is true. But so does everybody else. The person who is the most wealthy person in America gets breaks in here. If he or she is married, they also get relief from the marriage penalty.

So what we are doing, is saying we want to get relief from the marriage penalty, but not for poor married couples, only for everybody else. I do not think that is the right policy.

If we relieve people from the marriage penalty, we ought to do it for all the people who are affected by it. Certainly, if you exclude anybody, it should not be the poorest of the poor. So, I think the policy is correct.

Now, the offset, as I understand it, is to further

make worse the concern that I raised about the credit that American workers get for their income earned overseas.

I mean, I have got a lot of families in Louisiana that work in the oil fields in the North Sea and other parts of the world that really do so and risk their lives because they know they can keep more of their earnings.

That is a $32 billion tax increase right now in this bill for those families. I do not like that at all. This would make it even worse, by kicking the effective date earlier, as I understand it, to pay for the policy that Senator Jeffords is attempting to do.

So, while I like the policy that he is attempting to do for married people who happen to be low-income married people, I do not like the pay-for because it hurts other people who are working and raising their families and desperately need the income that they get.

Senator Santorum. Mr. Chairman?

The Chairman. Senator Santorum?

Senator Santorum. Mr. Chairman, I agree with the conclusion of the Senator from Louisiana, I just do not agree with his reasoning. The conclusion is, I oppose the Jeffords amendment.

But I think the idea that there is a marriage tax penalty, when we are talking about, not people paying

taxes, but the amount of money that the Federal Government is giving them in income support, is a fundamentally different issue than people who get married having to pay more money to the Federal Government in taxes.

So, there is a fundamental difference between people getting less support from the Federal Government by virtue of getting married, less of a welfare payment because they get married as opposed to having less taxes being paid. So, it is a fundamental difference between a tax issue and a welfare benefit issue.

Now, you can make the argument that people who get married should receive the same amount of aid from the Federal Government as people who are single and living separately. If you want to make that argument, that is fine. But this is not a marriage tax penalty because there is no tax being paid.

I just think we need to clarify that what we are talking about here are federal payments as opposed to taxes being paid by the couple. Thank you.

The Chairman. Senator Baucus?

Senator Baucus. He can go ahead.

The Chairman. Well, he wants closing remarks.

Senator Baucus. Well, before he closes, I think Senator Breaux made an excellent point. I do not agree,

frankly, with the analysis of my good friend from Pennsylvania.

Why in the world would you say everybody but lower-income people get the marriage penalty relief? It makes no sense to me, whatsoever. Also, knowing that the penalty hits them a lot harder than it hits upper income people or middle income people as a percentage of income. I mean, it is a whammy. It really hits.

I agree with Senator Breaux about the pay-for, but I am going to support this because I think the underlying policy is absolutely accurate. Second, I think the pay-for is going to get dropped out anyway in conference somewhere. That pay-for is not going to last. There is just not enough political support for it and it is going to go.

But let us take this example. Let us take a man who earns $17,500 a year, and let us say, has a child by a previous marriage, or whatnot. Let us say he is married and his wife earns $17,500. They have two children. She has a child. There are two children in the marriage.

Right now, today, they cannot get the benefit of the marriage penalty relief. That is, if they file as single taxpayers, they have got to pay, in total, a lot more in income tax than they would pay if they got the same relief that everybody else would get in the marriage

penalty relief. That is just not fair. That is not right.

I do not have the exact figures here, but I can tell you what the amount of the penalty would be. We are not talking about welfare recipients here, Senator. We are talking about people who earn income. They just do not have enough income to pay taxes.

We are talking about people who earn income and have children and do not get the advantage of relief in the marriage penalty that everybody else gets. These are not welfare recipients, these are people who earn incomes. The figure I gave was $17,500 for the man, and, say, for his wife. I just do not see why we cannot give the same benefit to both people that we give to upper-income people.

Senator Thomas. Mr. Chairman? I have a question.

Senator Baucus. Sure.

Senator Thomas. This is called tax relief, is it not? Marriage tax relief?

Senator Baucus. This is giving the same benefit to people paying taxes.

Senator Thomas. I am asking you a question. Is it called tax relief when they are not paying any taxes?

Senator Breaux. Marriage penalty relief.

Senator Baucus. It is a penalty relief.

Senator Thomas. Tax. Tax.

Senator Nickles. Mr. Chairman?

The Chairman. Could I please call on the Senator from Oklahoma?

Senator Nickles. Mr. Chairman, I know you are trying to wrap this debate up. But I think Senator Jeffords' amendment is interesting, but his example kind of proves the reason why it is bad policy no matter what the pay-for is.

Under his example, an individual with one child, $17,000 income, they get an Earned Income Tax Credit of $4,200 or $4,300, something like that. If you had two people in that scenario, presumably you should double that, so that would be $8,400 on a couple that makes a combined income of $34,000, $35,000.

That is ridiculous. Absolutely ridiculous. It is also the program that probably has more abuse, more inaccurate payments made, than any other program in the Federal Government. It has an error rate of about 30 percent.

The credit is not just to pay payroll tax or refund payroll tax. It greatly exceeds payroll tax. It greatly exceeds income tax. The credit is 40 percent on the first $10,000, or $11,000, whatever the base is. The individual pays, in most cases, no income tax and 7.65

percent payroll tax.

So, the Earned Income Tax Credit is many multiples of any tax that those individuals pay, and it should not be doubly compounded for a couple.

The Chairman. The Senator from Vermont.

Senator Jeffords. I will be very brief. Real life is what we are talking about here. You have a young couple, they are both working. They are about to have a child. They say, oh, we ought to get married.

They go to the people and they say, if you get married, you are going to lose $4,305 a year. If you do not get married, you will have $4,305 more a year to spend. So do not get married. So the kid has to grow up as a bastard. So what? You are going to have that much more money.

That is what we are talking about. This is real life. This is not the high-level tax policy for the Nation. This is real life. That is what we are talking about and that is what we are voting on.

The Chairman. Do you want a roll call vote?

Senator Jeffords. Absolutely.

The Chairman. All right. The Clerk will call the roll.

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.

The Clerk. Mr. Nickles?
Senator Nickles. No.
The Clerk. Mr. Lott?
The Chairman. No, by proxy.
The Clerk. Ms. Snowe?
Senator Snowe. No.
The Clerk. Mr. Kyl?
The Chairman. No, by proxy.
The Clerk. Mr. Thomas?
Senator Thomas. No.
The Clerk. Mr. Santorum?
Senator Santorum. No.
The Clerk. Mr. Frist?
The Chairman. No, by proxy.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. No.
The Clerk. Mr. Baucus?
Senator Baucus. Aye.
The Clerk. Mr. Rockefeller?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Daschle?
Senator Daschle. Aye.
The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Bingaman. Aye.

The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 10 ayes, 11 nays.

The Chairman. The amendment, accordingly, is defeated.

Senator Daschle? I was going to call on Senator Bingaman, but since Senator Daschle has come, if you are ready, Senator Daschle, I will go to you.

Senator Daschle. Thank you very much, Mr. Chairman.

Mr. Chairman, there is obviously a great deal of economic pain still found in most of rural States.

Obviously, one of the concerns we have is whether or not this bill will address that concern.

There are a lot of farmers and ranchers who literally have no farm income or ranch income at all right now. Farm income is the lowest that it has been since the Great Depression. We have never had income at levels this low in the last 70 years.

One of the concerns that a lot of farmers and ranchers have, is the impact that property tax has on that income, what limited income they have.

So, while we have a deduction currently that is available to those who pay property tax, obviously if you are not able to pay income, that deduction does not help.

So I will offer an amendment. I am offering an amendment which would provide a tax credit for just the next two years, this year and next year, to be applied against property tax of up to $1,000. It is $3,000 annually, but to those individuals, more than $1,000 in a commodity in a given year.

So it would be a $3,000 tax credit available to farmers and ranchers to offset the cost of property tax. Again, as I say, it would be sunsetted in two years.

This is one way that would be of great help to both farmers and ranchers as they struggle to try to make ends meet, try to address the concerns that they have with

regard to lack of income, not getting the payments that they were hoping to get from drought assistance.

The cost, overall, is about $2 billion per year, but we cap it. We sunset it at two years. I would hope that the committee would see fit to adopt it.

Senator Nickles. Would the Senator yield for a question?

Senator Daschle. I would be happy to.

Senator Nickles. I want to make sure I understand this. So you want a refundable tax credit equal to 65 percent of property tax paid on farmland.

Senator Daschle. Up to $3,000.

Senator Nickles. Up to $3,000. So this would be for any farmer?

Senator Daschle. That is right. Any farmer or rancher.

Senator Nickles. John Warner used to be a farmer, or had a ranch in Northern Virginia. So he would get two-thirds tax credit on his property tax up to $3,000?

Senator Daschle. That is correct.

Senator Nickles. I think this is a terrible idea, myself. So we do it for farmers but we do not do it for individuals, we do not do it for other businesses, we are just going to do it for agriculture? For two years, we are going to pick up two-thirds of the cost of the

property tax?

Senator Daschle. Well, we use the definition that USDA puts in the farm bill itself, which is that a farm is a place where you have got at least $1,000 in commodities sold. That is exactly what we have in the farm bill itself for eligibility for farm benefits.

So if you do it for the farm bill itself, you ought to be able to do it in situations like this involving situations where farmers and ranchers literally have higher property tax by far than they do income tax. This would provide a credit against the property tax, and we cap it and sunset it.

Senator Nickles. You mentioned in some cases farmers might have property tax higher than income tax. So is this means tested?

Senator Daschle. This is provided to all farmers who meet the farm bill definition. About two million farmers, but about a quarter of that number, between 400,000 and 500,000, have gross farm incomes of over $40,000.

Senator Nickles. Correct me if I am wrong, but some farmers do very well. Senator Grassley tried, but we were not successful in capping farm subsidies. But a lot of farmers receive a lot of subsidies, so this would just be added to that?

Senator Daschle. Well, as I said, we cap it at $3,000. I am sure, for most large farmers, that would hardly be worth the paperwork. But for a lot of farmers and ranchers, that $3,000 means a lot.

That is what we are trying to do by capping it, by reducing the administrative costs, we do not get into means testing or any of the things that I know that the Senator from Oklahoma has been opposed to on many occasions in the past. We try to make this as simple as possible, getting help through the Tax Code, property tax relief. The National Farmers Union, the Farm Bureau, has said this is the single most important tax provision that will be considered during the debate on this economic stimulus package.

I would ask unanimous consent that both the letters from the Farmers Union and the Farm Bureau be inserted in the debate in the record at this time.

[The letters appears in the appendix.]

Senator Nickles. Mr. Chairman, I would hope that we would vote no on the amendment. I think Senator Smith wanted to make a statement.

Senator Smith. Just a question, if I may. What is the pay-for, and how does this affect States who have farm deferral programs for situations just like this? Do they get the credit even though they get the deferral of

the taxes?

Senator Daschle. They do. All farmers and ranchers would be eligible for the $3,000 farm credit if they pay a property tax.

Senator Smith. But a lot of States have deferral programs when they do not have certain levels of farm income.

Senator Daschle. Well, that is what I say. If they are eligible for the deferral, if they are not paying the property tax, they are not eligible for the credit.

The Chairman. Does the Senator want a roll call vote?

Senator Daschle. Yes, I would.

The Chairman. Would the Clerk call the roll?

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

The Chairman. No, by proxy.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

The Chairman. No, by proxy.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. No.

The Clerk. Mr. Frist?

The Chairman. No, by proxy.

The Clerk. Mr. Smith?

Senator Smith. No.

The Clerk. Mr. Bunning?

The Chairman. No, by proxy.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Daschle?

Senator Daschle. Aye.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Baucus. Pass.

The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. I would like the $3,000, but I am going to vote no. [Laughter].

Senator Breaux. Vote your conscience.

The Clerk. Mr. Chairman, the tally is 9 ayes, 11 nays, 1 pass.

The Chairman. The amendment is, accordingly, defeated.

Senator Lincoln? We were going to call on Senator Bingaman, so I will get him when he comes back.

Senator Lincoln, let us wait for Senator Bingaman.

Senator Lincoln. Sure. He can go ahead.

The Chairman. Senator Bingaman?

Senator Bingaman. Mr. Chairman, I had two amendments I wanted to offer. You just want one of them right now, right?

The Chairman. No. Could we take them en bloc?

Senator Bingaman. No. [Laughter]. You can take them in sequence, if you would like.

The Chairman. Let us take them in sequence then.

Senator Bingaman. All right.

The first, is an amendment to simply provide the unemployment insurance benefits that we all have talked about and agreed should be extended at this point, and extend those. We have over 4 million people out there who are unemployed and looking for work.

I heard the Chairman's comments to the effect that the percent of unemployed is not as high now as it was the last time we had a recession. The total number of people is higher today and the number of people who have been unemployed for at least six months is greater, as I understand it, than it was in the prior recession.

I think, for those who are unemployed and looking for work, it is not a lot of solace to tell them that the statistics, in some respects, may have been worse at some previous time in our history, so we are giving them no benefits.

In order to be eligible to qualify for these benefits, you have to have worked and you have to be able to demonstrate that you are continuing to look for work. These benefits are not exorbitant. In my State, a person receiving unemployment benefits gets $203 a week.

That is not a whole lot with which to raise a family and try to keep a family together. So, I think it is essential that we adopt this. It costs a little over $13 billion. The amendment I am offering is co-sponsored by

Senators Baucus, Rockefeller, Daschle, Kerry, Senator Jeffords.

I propose that we offset it by freezing the 10 percent additional exclusion for tax-free dividends, instead of going to 20 percent. I think that substantially more than offsets the cost of this. So, I would hope that we could agree to this, and I would proceed to my second amendment.

Senator Nickles. Mr. Chairman?

The Chairman. The Senator from Oklahoma.

Senator Nickles. Mr. Chairman, we have wrestled with this amendment several times on the floor and we defeated it on the floor several times over the last three or four years, where people have basically tried to double the federal unemployment program, which is supposed to be temporary.

Presently, it is 13 weeks, the Senator's amendment would make it 26 weeks. That is on top of a 26-week State program. That is 52 weeks. In addition to that, the Senators amendment allows some States to receive an additional seven weeks. That would be a total of 59 weeks.

It is an enormously expensive program. We have in the past extended the federal 13-week program, but the Senator's amendment would not only extend it, it would

double it. Not only would it double it, it also expands the number of people who would be eligible, including temporary employees. So, it gets very expensive very quickly.

In addition to that, there is an additional seven weeks, so there would be a total of 59 weeks. Present law is 26 weeks, State, 13 weeks, Federal. If we adopted this amendment, the Federal Unemployment Compensation Fund would be bankrupt in very short order. I would urge my colleagues to vote no on the amendment.

The Chairman. I said before on another amendment that we are going to probably have an extension of current law before it expires before the end of May. But this amendment, I think, is like other ones that we have had, unprecedented, unjustified expansion of unemployment compensation. So, I would urge defeat.

Would you like closing remarks on your amendment?

Senator Bingaman. Just very briefly, Mr. Chairman.

The statement my friend from Oklahoma said, was that it was going to bankrupt the fund. My information is, the fund has over $20 billion in it. The 10-year cost of this is $13 billion.

There will be a lot of money paid in over the next 10 years in addition to the $20 billion that is already there. This is money that is paid in to assist workers

who are out of work, through no fault of their own.

That is exactly what we are proposing to do here. If you want something that will stimulate the economy, it is to give these people some minimal amount of funding that they can use to continue looking for a job.

So, I urge my colleagues to support the amendment and I ask for a roll call vote.

The Chairman. Would the Clerk call the roll?

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

The Chairman. No, by proxy.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

The Chairman. No, by proxy.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. No.

The Clerk. Mr. Frist?

The Chairman. No, by proxy.

The Clerk. Mr. Smith?

Senator Smith. No.

The Clerk. Mr. Bunning?

The Chairman. Mr. Bunning, no, by proxy.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Daschle?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Bingaman. Aye.

The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 10 ayes, 11 nays.

The Chairman. Accordingly, the amendment is defeated.

Before I go to Senator Bingaman's second amendment, then I think Senator Lincoln, for sure, how many more amendments would we have? Any on the Republican side?

[A showing of hands]

The Chairman. One by Senator Smith. Is it fair for me to ask on this side how many amendments we will have?

Senator Baucus. It is fair to ask. [Laughter].

The Chairman. Well, could you please raise your hand if you have any more amendments other than the two I mentioned on your side?

[A showing of hands]

The Chairman. It looks to me then that we have three amendments left. Then we would be able to vote.

Senator Bingaman first, then Senator Lincoln, then Senator Smith. Is that all right, Senator Smith?

Senator Baucus. There may be more than three.

The Chairman. Well, there could be more than three. Hopefully, there will not be.

Senator Bingaman?

Senator Bingaman. Thank you very much, Mr. Chairman. This amendment is one that is listed as

Bingaman Amendment Number 3.

I would revise it slightly to accommodate the various modifications that the Chairman has made in his own mark.

The Chairman. Accordingly modified.

Senator Bingaman. Thank you.

This amendment would cost somewhere between $350 and $400 million, not billion, so this is a very modest amendment compared to those that we have been considering here in the committee this afternoon.

The cost, as I am proposing it, the offset, would come out of this $20 billion package in State fiscal relief. Essentially, we would be earmarking less than 2 percent of that package to meet this need.

The amendment would provide to extremely low DSH State, that is, disproportionate share hospital States, the ability to respond and increase payments to their safety net hospitals, which are facing increasing uncompensated care rates due to the poor economy that we are experiencing.

The idea of the $20 billion in State fiscal relief, I know the Chairman described, is to make that flexible to the States as to how they spend that. The reality is, there is currently in law a cap on what can be spent by the States from Medicaid for this purpose.

We would try to remove that cap and allow States,

instead of spending 1 percent of their Medicaid allotments for this purpose, they could spend up to 3 percent.

There are 20 States that have their Medicaid disproportionate share hospital, or DSH, payments limited to less than 3 percent of overall Medicaid program spending. Most of those States are called extremely low DSH States. They are limited to less than 1 percent of overall Medicaid spending.

In sharp comparison, the State average received a federal DSH allotment of around 8 percent, or 800 percent the amount that these States are receiving.

As it turns out, there are 11 States represented on this committee that find themselves in this circumstance. Those States include Montana, South Dakota, North Dakota, New Mexico, Arkansas, Iowa, Utah, Oklahoma, Oregon, Tennessee, and Wyoming.

As the economy has dipped into recession, hospitals have seen higher percentages of uncompensated care, more and more people coming to the hospital who really do not have coverage at all. Those are the exact hospitals, the exact circumstances that this program is designed to deal with.

I believe this amendment is essential if those hospitals are to be given any chance of responding to the

increased demand being made on them. This amendment has the endorsement of the American Hospital Association, the National Association of Public Hospitals and Health Systems, the National Association of Children's Hospitals, the Association of American Medical Colleges, and the Federation of American Hospitals.

In the support letter that they have sent me, which I would offer to be included in the record, Mr. Chairman, they state, "Presently, safety net hospitals," and that is what we are talking about here, "are facing a confluence of challenges, including increased uncompensated care due to the rise in the uninsured population that is putting critical pressure on hospitals' ability to serve their entire communities."

[The letter appears in the appendix.]

Senator Bingaman. The Bingaman-Lincoln amendment would help hospitals continue their mission of guaranteeing access to quality health care for all Americans.

Mr. Chairman, I would urge all Senators to support the amendment.

Senator Thomas. Mr. Chairman?

The Chairman. Who asked to speak? Senator Thomas?

Senator Thomas. Mr. Chairman, I am pleased to hear what the Senator talked about. I am also chairman of the

Rural Hospital Caucus in the Senate, and we have a bill pending now that would deal with this.

We also got part of it passed last time. We increased the standard payments. We increased the DSH payments. We continue to work, because there has been a disparity between urban and rural hospitals, and we have a very active group of rural hospital people here, and we are talking about under-served areas.

So, I could not agree more with the purpose that the Senator describes, but I do not think it fits in this bill. There are bills out there to deal with this issue.

Senator Conrad. Mr. Chairman?

The Chairman. Senator Conrad?

Senator Conrad. Mr. Chairman, I would just say, if the Senator from Wyoming is referring to the bill that we have jointly introduced, I would just remind our colleagues, that deals with Medicare. The Senator's amendment deals with Medicaid.

I do not know of a bill that is out there that deals with the problem that he is attempting to address in his amendment. It is a very serious problem, certainly on the Medicare side, but it is also a huge problem on the Medicaid side.

I just had a number of our hospital administrators in from my State, and this DSH payment, the disproportionate

share challenge for these institutions, is mounting.

I just had the hospital administrator from the little town of Devil's Lake in. She showed me their unreimbursed accounts for this little institution of over $1 million. She told me that it threatens the viability of that institution. It serves a town of about 8,000 people.

So, I would hope Senators would give close consideration to the Senator's amendment. It addresses a real need out there and it is a growing need, and we have got to find a way to address it or it is going to close institutions. That means the patient load will have to go elsewhere at even greater cost. That is the irony of this.

In our State, if that patient load gets shifted to another institution, it will get shifted to a higher-cost institution, because those are the only institutions anywhere close by.

Senator Thomas. May I ask a question?

The Chairman. The Senator from Wyoming.

Senator Thomas. We have this $20 billion you all have been pushing. Now, is that not partly for Medicaid?

Senator Bingaman. Mr. Chairman, could I respond on that?

The Chairman. Yes.

Senator Bingaman. Yes, it is unprescribed at the current time, as I understand it. What my amendment seeks to do, is to say that this amount, $350 million, or less than 2 percent of that $20 billion, would be used for this purpose.

So, all I am saying is, of the amount that is already in the Chairman's mark, let us see to it that this fiscal relief is provided to the States that obviously need it for this purpose. That is what we are trying to do.

Senator Thomas. I thought we had sort of an agreement that, for the definitions on that $20 billion, we were going to wait until we got to the floor.

Senator Lincoln. Mr. Chairman?

The Chairman. Please proceed. Go ahead.

Senator Bingaman. I was just going to say that I am urging the committee to provide in this mark that we present to the floor specific instructions that this part of it will be protected and will be compensated, because I think the need is enormous in these safety net hospitals in this particular group of States that have been getting short-changed on these disproportionate share hospital payments for many, many years.

Senator Santorum. Mr. Chairman?

The Chairman. Senator Baucus, then Senator Santorum.

Senator Baucus. Mr. Chairman, I hope the Senators listen to Senator Conrad, because what he said about North Dakota is certainly true in Montana, and I daresay in many States.

That is, rural hospitals who incur tremendous costs, in particular with low-income patients or patients who just get charity care, are having an extremely difficult time.

I wish you could go to some of these hospitals in some of these rural areas and see them. It is incredible. Your heart just goes out to the administrators, the personnel, the nurses and the doctors there that are just trying to make ends meet. It is extremely difficult.

I know that big-city hospitals have problems, too, but I have got to tell you, they have much higher volumes which enable them to differentiate costs and revenue in a way that helps them stay alive. But in rural hospitals, that is not the case. I just strongly urge us to proceed.

Now, this is not Medicaid, MFMAP, that we are talking about here. Medicaid goes essentially to people, to beneficiaries. We are talking about hospitals here. The hospitals here need the reimbursement rates. I do not want to say what is needed in Wyoming, Senator, but I

have got to think that Wyoming hospitals really need this pretty badly, as I know is the case in other rural hospitals.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Santorum has got to be first, then the Senator from Oklahoma.

Senator Santorum. Mr. Chairman, I think the Senator from New Mexico and the other Senators on the other side have made a good case. I think what the Chairman has decided to do--I do not want to speak for the Chairman, but I think in our conversations over the last few days the feeling was that we would work on a package on the floor that very well may include this provision, but balancing the interests of a variety of other concerns about how is the best and most effective, meaningful way to help the States out, and building a package that can get the number of votes that we need to pass the U.S. Senate.

So we are going to sit down, and the Chairman will sit down with members, to try to put together a package that will effectively help the States in a way that we can successfully move this bill forward. We are really, in a sense, reserving all those options, and this may be one of them, to accomplish that when we get to the floor.

I think prejudicing that by putting this in would be

inappropriate at this time. I think there is an opportunity, under the right circumstances, for something like this to potentially be included.

Senator Lincoln. Mr. Chairman?

The Chairman. The Senator from Oklahoma, first.

Senator Nickles. Mr. Chairman, I thought someone said the DSH was not part of Medicaid. It is part of Medicaid. In the State assistance, we do specifically mention Medicaid. So, I think it can be handled in the State assistance and I do not think the amendment is necessary at this point.

Senator Lincoln. Mr. Chairman?

The Chairman. The Senator from Arkansas.

Senator Lincoln. Thank you, Mr. Chairman.

I am a co-sponsor of Senator Bingaman's amendment to allow the low DSH States to increase their DSH spending. I just want to say, if this committee is not the place to do this, where we are supposed to be looking deliberatively at ways to stimulate the economy in our States, I do not know where is.

This is a huge stimulus provision that we could put in this bill. We could dedicate these dollars to this. As we look out in our States and the economy struggles, people are being laid off. States are cutting Medicaid. The number of uninsured has increased. In our State,

particularly, I have watched where a small, rural hospital had the potential to close its doors.

What was going to happen, we were going to lose a processing facility in the same county, then lose another processing facility in an adjoining county which was a sister plant to the one there, all because of the liability that those plants would incur because the hospital closed down.

So, if it is not a stimulus, maybe it is just stopping the blood flow of the problem that we have in rural America. The uncompensated care provided by Arkansas safety net hospitals has also increased, and these circumstances all hit our low DSH States the very hardest. We are classified as a low DSH State because its DSH allotments had been capped at 1 percent of their overall Medical Assistance payments to Medicaid.

We are locked into that formula in Arkansas, and it is simply unfair. Payments in other States throughout the country average 9 percent. So, this amendment increases the spending to 3 percent of program costs. It may not be the national average, but it certainly would be a huge help to States like Arkansas.

We have one of the highest rates of uninsured and Medicaid patients in the Nation and we greatly depend on our disproportionate share safety net hospitals to

provide them with health care. It is not just health care, it is maintaining the jobs in rural America.

If we do not maintain those jobs in rural America with this kind of a stimulus aspect, they are going to go away and we are going to be an even greater burden on the Federal Government.

So, I just implore my colleagues, this can be very much a stimulus piece of this bill, and I think it is a great way to look at dedicating some of those State assistance dollars.

I think the committee is a very appropriate place to do that, as we are all here discussing the issues of our States. I encourage my colleagues to support Senator Bingaman.

The Chairman. Rather than speaking against the amendment, I would like to reason a little bit, if I could, with the Senator from New Mexico, because I have not heard any arguments that I disagree with. So that means I ought to vote for your amendment, particularly since I sponsored legislation in the last Congress along this line.

But this is how I see it. Number one, if we would agree to your amendment, then other interests that would like to get in and have this committee make a decision rather than making it on the floor in this more broad

group that I wanted to include in this in making this policy, then they would be encouraged to do that, and I think legitimately so. That is probably the most important thing, is to maintain the flexibility that I promised.

Maybe what I should say is, since I am sympathetic to what the Senator from New Mexico is trying to do, I would be glad to work along the lines of getting some inclusion of DSH hospitals in the program on the floor. But I do not want to be locked into that.

So, I just wondered if there is any chance that the Senator from New Mexico would work with us on that on the floor rather than push his amendment at this point.

Senator Bingaman. Well, Mr. Chairman, let me just state my concern. You can tell me whether or not this is a concern that you think we could overcome.

The Chairman. Well, let me ask my staff to pay attention then so I can consult with them. [Laughter]. I do not want to make a promise I cannot keep.

Senator Bingaman. As I understand the modification of the modification of the Chairman's latest mark, there is $20 billion that is intended to be fiscal relief to the States.

If this were just a question of, how are we going to spend that money, then I think, clearly, the Chairman's

approach might be an appropriate way to go. The concern I have got, is that current law caps the amount that these 20 extremely low DSH States can spend on their disproportionate share hospitals out of Medicaid.

So, I am trying to get us to agree to change that cap so that they would be able to spend up to 3 percent, basically. So I am just concerned that it is not just a question of allocating the $20 billion that is provided for in the Chairman's mark. It is also changing a substantive provision in the Medicaid law, and that is why I am offering my amendment.

So, tell me how we get all that done if we do not adopt this amendment right here.

The Chairman. Steve, do you have any comment on that?

Mr. Robertson. I would just suggest that the purpose of the underlying amendment that is in the Chairman's mark----

The Chairman. Well, wait a minute. I think you ought to address his concern. Would he be precluded on the floor of trying to accomplish what he wants to accomplish?

Mr. Robertson. No. No. That is what I was about to explain, why it is true that you would not be precluded.

Senator Bingaman. Good enough. Thank you very much.

Mr. Robertson. The purpose of the underlying amendment, by specifying increases to the States under Title 19, we have attempted to create the germaneness link so that any amendment offered on the floor that actually did, as you suggest, change the DSH formula, raise the cap, change the FMAP formula, that those statutory changes to the underlying Medicaid program under Title 19 would be in order because, in effect, what the Chairman's bill allows for is changes in Title 19. So the intent here would be, any amendment such as yours would be in order and germane to the underlying bill.

The Chairman. To the Senator of New Mexico, if you want a vote, we will take a vote. But I will make a commitment to work with you on it, even if your amendment is defeated.

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus?

Senator Baucus. Mr. Chairman, I still think there is a question of germaneness here. My staff has just talked to the parliamentarian, and I am informed that the current, most recent language is not adequate to pass muster on the question of germaneness.

I think all Senators should know that, which, if

true, would mean that Senator Bingaman's amendment, on the floor, would need 60 votes. I do not know how Senator Bingaman wants to proceed if that is the case, but my staff just talked to the parliamentarian.

We do not have a written statement from the parliamentarian. This new language is supposed to correct some defects, but I do not think it corrected enough defects, according to what the parliamentarian is now saying.

So, Senators should, therefore, be forewarned, if I am accurate in the information I have, that they are going to need 60 votes to proceed and prevail on this amendment.

The Chairman. Before I say something in response to you, it is my understanding that our staff also talked to the parliamentarian. Maybe it was included in your comment you just gave, but would you comment specifically on that issue of the parliamentarian?

Mr. Robertson. Well, since it appears that we have had separate conversations with the parliamentarian at different times, I cannot conclusively say what he said when I was not there.

The Chairman. All right.

Mr. Robertson. I mean, I have been here.

The Chairman. Then let me say this. Can I say this

to Senator Baucus and to Senator Bingaman? There is another forum coming up in this committee where I was expecting to deal with this issue.

Now, exactly whether I was going to deal with it the same way you are dealing with it, I do not want to say at this point because I do not think I have formulated that policy. But I see it as a problem.

So, even if the Senator from Montana is correct, we still would have that other forum that I intend to----

Senator Baucus. What is that, Mr. Chairman?

The Chairman. Well, I think that a lot of this stuff for rural health care is going to have to be dealt with when we deal with the issue of Medicare prescription drugs.

Senator Baucus. Well, Mr. Chairman, we do not know what the fate of that bill is going to be.

The Chairman. No, you do not know the fate of that bill. I wish I did.

Senator Baucus. But we know the fate of this bill. This is a strong horse. This bill is going to be enacted and passed by the Congress. We have no idea where Medicare is. We do not know.

The Chairman. As far as I am concerned, it is going to pass.

Senator Baucus. Well, I hope you are right, but no

guarantee.

The Chairman. The Senator from Oregon.

Senator Smith. Mr. Chairman, I would be strongly inclined to vote for the bill that the Senator from New Mexico is offering, but I trust your word. If you are telling me that we are going to work out DSH language that is good on the floor that you would support, then I am going to vote however you vote on this. But I think this is critical for my State, it is critical for your State. This is a very important issue.

Senator Lott. Parliamentary inquiry, Mr. Chairman.

The Chairman. Parliamentary inquiry. Did you want to speak?

Senator Lott. Just a parliamentary inquiry. I just wondered, are we about to begin some votes or do we know when that might be?

The Chairman. Let us finish this, then we will discuss that.

Senator Lott. All right.

The Chairman. Senator Baucus?

Senator Baucus. We all want to work out State aid. Different Senators have different points of view what constitutes correct State aid. I mean, that is the problem here. We all have tremendous faith in the Chairman, but different States have different points of

view on State aid.

There is going to be no guarantee that, with the Chairman's best interests and best efforts, we are going to get an agreement, because Senators have a constitutional obligation to support their States' points of view.

In addition to that, I think we run a real risk that, despite the best efforts and the best intention here of putting this together, we may need 60 votes. For example, the low DSH payment may need 60 votes, based upon what we have. The conversation my office had with the parliamentarian was just five minutes ago. So, that is the predicament that we are in here.

We also have to ask ourselves, why are we here? I mean, we are the Finance Committee. We should have some way in what the $20 billion is all about. I just feel that we should strike a right balance here of somewhat addressing what the provisions should be, but leaving the balance up to the Chairman and all who are interested to work out the rest of it, particularly since a majority in this committee, I think, want to vote in favor of this low DSH payment provision.

That is my guess, all things being equal. And it is a small amount. It is $300 million out of a $20 billion package. It just seems to me that this is one area that

perhaps we can get some agreement and accept the amendment. It is a small amendment compared with the whole $20 billion. Then we can work out the rest of the $19.7 billion among ourselves.

The Chairman. It seems to me that it is everyday procedure in the U.S. Senate to make sure that amendments that are constructed can be done in a germane way, and it seems to me that it would be part of the process to satisfy everybody's needs.

Senator Bunning, then I will see what we can work out with Senator Bingaman.

Senator Bunning. Thank you, Mr. Chairman.

We have had difficulty before with the parliamentarian giving us one opinion verbally and having a written opinion the other way.

The Chairman. Start over again. Start over again, would you please?

Senator Bunning. We have had difficulty with the parliamentarian giving us a verbal commitment one way and a written commitment the other way already earlier this year. Do not shake your head, Max, because it has happened. We are working in a republic. We are not working in a true democracy.

So you are sent here to vote your conscience and not your interests of your State, if it is not in the

interests of the United States. So, I want to distinguish that from what you may have just said as to being factual. I know one thing. I am going to vote what I feel is in the best interests of the United States, not just Kentucky.

The Chairman. Senator Bingaman, would you like to have a vote now? I am still going to keep my commitment to you.

Senator Bingaman. Mr. Chairman, I very much appreciate that. Obviously, your commitment is worth a tremendous amount. Let me just explain, very briefly, why I still think it would be good to do it here.

There are 20 States that are so-called low DSH States, that get less than 1 percent or have this cap of 1 percent on what they can spend for Medicaid funds for the safety net hospitals.

It just happens that 11 of those 20 States are represented on this committee. Twenty States is not half of the full union, but 11 is more than half of 20. So, I would very much like to see us go ahead and do this while we have the opportunity here.

Obviously, if we are not successful, then I would be anxious to work with you to try to address this on the floor. I do think Senator Baucus raises a very good question as to whether or not we will run into some

points of order or other objections when we get to the floor, so I would ask for a vote on the amendment.

The Chairman. Would the Clerk call the role, please?

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. No.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

The Chairman. No, by proxy.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. No.

The Clerk. Mr. Frist?

The Chairman. No, by proxy.

The Clerk. Mr. Smith?

Senator Smith. No.

The Clerk. Mr. Bunning?

Senator Bunning. No.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Baucus. Pass.

The Clerk. Mr. Daschle?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Bingaman. Aye.

The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 9 ayes, 11 nays, and 1 pass.

The Chairman. Accordingly, the amendment is defeated.

Senator Lincoln?

Senator Lincoln. Thank you, Mr. Chairman.

The Chairman. To answer Senator Lott, before you go, I think that Senator Lincoln has an amendment, then Senator Baucus and I need to work on some amendments here, then we may be close to a vote.

Senator Lincoln. There is a vote on the floor, too.

The Chairman. There is?

Senator Lincoln. My pager just went off.

The Chairman. You have got to be kidding. Is there a vote on the floor?

Senator Lincoln. Yes, sir.

Senator Nickles. They notify the Democrats quicker than they do the Republicans. [Laughter].

Senator Lincoln. I am the only one that wears my pager.

The Chairman. Then let us go to your amendment. If we can agree on something here, we might get done right now then.

Senator Lincoln. Thank you, Mr. Chairman.

The amendment that I am offering today is very similar to a bill introduced by Senator Smith and Senator Corazon to advance the re-funding of State and local bonds for facilities used for government functions. As Senator Bunning has mentioned, we are not here just for

our States. However, this is particularly important to Arkansas.

It is particularly important to education across our great land. Since we have not been able to fund except $2 billion of the $8 billion for No Child Left Behind, many of our schools are finding themselves in situations where, whether it is from the State perspective or certainly from their local perspective, that they are running out of money.

Without the necessary money, the commitment that we have made on the federal level, they are finding themselves in very dire straits. So, I would like to modify that bill in the form of my amendment, which would allow for the additional advance re-funding of bonds for public, elementary, or secondary schools.

As most of my colleagues know, under the law, State and local entities are limited in the amount of time that they can do a refinancing of bonds that they have issued in order to get lower rates. If they exceed the number of refinancings, the bonds they issue are taxable bonds.

Senator Corazon and Smith's bill, which would have allowed the States and local governments to do an additional advance re-funding, that is what I am proposing to do in this amendment, particularly for elementary and secondary schools.

I am a co-sponsor of the other bill, but I do not need all of it in terms of an emergency circumstance right now.

Our State Supreme Court in Arkansas has ruled that our State's school funding system was unconstitutional, and many of our school districts are being forced to refinance.

So, it has become a very, very difficult situation for us in Arkansas. I imagine it will be that way for many school districts and school systems across the Nation.

I would like to offer this amendment that I believe could help all of our school districts, and certainly our States, in being able to meet those needs.

It is a pretty pressing issue for us because the Supreme Court has given us a deadline of this year, particularly, September 30. We are looking towards what we have to do in order to make sure that that happens. So, we find ourselves in our State in a critical circumstance, but I know across the Nation other States and other school districts are having a difficult time.

It is amendment 134 on the overall list. It is the second amendment under "Lincoln." I have proposed to pay for it by freezing the 20 percent dividend exclusion by only one year to 10 percent, and this will be able to pay

for this. I think the cost was $1.9, almost $2, billion.

I do know about the rest of you all and your States, but I think nationwide, education has come under a critical circumstance of being able to provide the kind of training in technology that our children need, not only to be the leaders of this country tomorrow, but also to be the workforce.

If we are truly to stimulate what needs to happen in this economy, we need to be assured of having a workforce that is trained and capable of being competitive in a global marketplace. Without the kind of funding we need in Arkansas, and I am sure other States are going to need, it is not going to happen.

So, I would encourage my colleagues to take a look at it if you have not already. Again, it would only require a freeze of that 20 percent dividend exclusion for just one year.

Again, I cannot think of any better stimulus in our States than being able to allow our local school districts and our States to be able to advance the re-funding of those bonds for public, elementary, and secondary schools.

So, I encourage all of my colleagues to help us out in Arkansas, and I think you will find that your States will take great advantage of it as well.

Senator Nickles. Senator Bunning?

Senator Bunning. Thank you, Mr. Chairman.

I am a co-sponsor of the bill, so I really like the policy. I just cannot stand the pay-for. If you had a different method of paying for it, maybe we would get a lot more support around the table.

Senator Lincoln. Have you got a suggestion?

Senator Bunning. If I did, I would not give it to you. [Laughter].

Senator Lincoln. If you like the policy.

Senator Bunning. Somebody would use it up before I got to it.

Unfortunately, what you have stated is accurate. There is a limit to how many times you can re-fund bonds. When you pass that limit, then they become taxable. The policy is right, the pay-for, I cannot support.

Senator Lincoln. Well, I am open to suggestions if you have other pay-fors. I am ready to get the policy forward so we can save our schools.

Senator Bunning. I am looking around this table and I do not see anybody that is looking for a pay-for. So, I am sorry, I cannot support it, but it is good policy.

Senator Nickles. Just for the information of our colleagues, we have about 10 minutes left on the vote.

I am just wondering, Senator Lincoln. You mentioned

that you had a couple of amendments.

Senator Lincoln. Yes, sir, I do.

Senator Nickles. Was this 134 or 135?

Senator Lincoln. It is 134.

Senator Nickles. 134.

Senator Lincoln. You will notice that 133 and 135 did the same thing, but in different increments.

Senator Nickles. I see an estimate on 133 as a cost of $13 billion.

Senator Lincoln. That is right.

Senator Nickles. I do not see an estimate on 134 or 135.

Senator Lincoln. Right. We did not have one at the time. But I think Joint Tax has given us one, and it is $1.97 or $1.946 billion.

Senator Nickles. About $2 billion?

Senator Lincoln. Yes, sir. That is correct.

Senator Nickles. Then did you have an additional amendment as well?

Senator Lincoln. I had several other amendments. Yes.

Senator Nickles. Since you have several other amendments, why do we not vote, then we will come back and deal with all of your amendments. I would urge all of our colleagues to vote and come back immediately and

finish Senator Lincoln's amendments. I believe then we will be close to voting on final passage.

Senator Lincoln. Well, I certainly, again, would encourage my colleagues. We are in dire straits with education in our States, and this is a great way to help them out. It only puts the freeze for just one year.

Senator Nickles. The committee will recess and return no later than 5:20 to resume consideration of the Lincoln amendments.

The committee is in recess.

[Whereupon, at 5:05 p.m. the meeting as recessed.]

AFTER RECESS

[5:55 p.m.]

The Chairman. I was trying to work out here some agreements on some amendments that are left to avoid continued long discussion. But on my side of the aisle, I do not have agreement that we should do that. Consequently, that means that the Democrats have a considerable number of amendments to offer.

So, I think we will proceed with the amendments. It is probably going to take much longer than I was hoping it would take to get this bill out tonight, but I want to move forward.

I think Senator Lincoln is a person that is ready for an amendment at this point.

Senator Lincoln. I had an amendment pending, I believe, Mr. Chairman.

The Chairman. Yes. You had an amendment pending.

Senator Lincoln. Right.

The Chairman. Did you want a roll call vote on your amendment?

Senator Lincoln. I actually would like to ask if there is a possibility, in terms of changing that amendment. We looked at the possibility of offering my other amendment; Senator Nickles had questioned which of those three. The last one only costs $30 million if we

modified it. We worked out, I think, during the vote on the floor, a pay-for with the staff.

The Chairman. If we have a manager's amendment, your third amendment is included in our manager's amendment.

Senator Lincoln. So if there is one.

The Chairman. Yes. And you are dropping the other two, then?

Senator Lincoln. Yes, sir.

The Chairman. You would drop the other two then? You would, please, drop the other two? [Laughter].

Senator Lincoln. The previous amendment on the advanced re-funding, yes, sir. I would still have one other amendment.

The Chairman. All right.

Senator Lincoln. Is that all right?

The Chairman. Her other amendment is withdrawn. Proceed to the amendment you want to bring up at this point.

Senator Lincoln. All right.

The next amendment, Mr. Chairman, is 137. It was to accelerate the refundability of the child tax credit. Is there another amendment that could go right now?

The Chairman. No, I think you are the last one. We have got a manager's amendment worked out.

Senator Breaux. I have got something I want to raise.

The Chairman. I did presume that there was not. I am wrong. Let us go to Senator Breaux, then to Senator Rockefeller.

Senator Lincoln. Thank you.

Senator Breaux. I just want to raise a point that we have discussed with a number of amendments. This issue has been around for quite a while, and it deals with Puerto Rico.

A number of our colleagues on your side of the aisle, Mr. Chairman, have shared the same concern I have with the country of Puerto Rico with regard to U.S. companies doing business in Puerto Rico.

Unlike companies that leave the United States to do business in Malaysia, Mexico, Singapore, or other countries, doing business in Puerto Rico is doing business in the Commonwealth of Puerto Rico, where they are U.S. citizens who are subject, in all of their employment practices, to the same environmental laws that we have in this country, the same minimum wage laws that we have in this country, and what have you.

It is clear that when you do business over there, the profits that are earned by U.S. business and brought back to the United States' mainland are still being subject to

the U.S. tax, which makes up the difference if it is a low tax in the country where they are doing their foreign business.

Now, the situation was made better by the whole Section 936, which carved out an exemption for Puerto Rico in this area. But the exemption is now gone, and we have got the Commonwealth of Puerto Rico with 20 percent unemployment. These are people we have the responsibility for in health care and Medicaid.

What is happening in countries, if they are treated just like being in some of the third world countries, they are going to go over there. I would much rather have U.S. businesses operating in Puerto Rico, providing jobs for Puerto Ricans, helping us in caring for some of their health care needs.

So we have come up with a concept to give companies that do business in Puerto Rico, when they bring money back here and invest it in the United States, a break so they do not have to make up the entire business in the tax rate that they would pay in Puerto Rico versus over here.

I have talked to some of my colleagues on the Republican side, and maybe they could be heard on this. I am not sure what to do with this. This is a problem. We ought to deal with it. It is a tax problem. This is

a tax bill. I am not sure whether we do it here.

But, anyway, I bring it up for discussion. I think it is the right thing to do. These are American citizens in that part of the world. With 20 percent unemployment, we are going to pay for it one way or another, pay me now, or pay me later.

I just think encouraging U.S. businesses to locate there as opposed to foreign countries makes good public policy for the United States. We can do something on this in the tax bill. I do not know whether there is enough support to do that, quite frankly.

After 6:00 p.m.

Senator Santorum. Mr. Chairman?

The Chairman. Yes. Proceed, Senator Santorum.

Senator Santorum. I would just like to say, I want to commend the Senator for bringing this up. I think this is a very important issue. I, too, am concerned whether this is the right vehicle to bring it up on.

This is an economic growth package and there is not any area of the United States which is suffering more chronic unemployment and economic distress than the island of Puerto Rico.

They are American citizens, and they are good American citizens. Many of them just fought valiantly in the war in Iraq, and we have to be concerned about them and their well-being. We have had provisions in the

past. I know the Senator, and many on this dais, have served on the Ways and Means Committee. We worked on them when I was over there.

I just want to express my support for acting on this. I think it is important to create some economic incentives for companies, many of whom are down there right now. Manufacturing is a very, very big part of the Puerto Rican economy. Everybody thinks that it is basically a place for tourism, but manufacturing is a huge part of their economy.

It was driven by incentives that the Federal Government created in Section 936. We have scaled that back substantially, and I think it is important for us to look at the consequences of that to see if there are not some things we can do here to be helpful.

So, with that, I would just throw that out to the Chairman and ask for his consideration, either now or at some other point.

Senator Nickles. Mr. Chairman? I just urge my colleagues, I think there is some merit, but I do not think this is the right time or the right bill.

I remember when we worked on 936. There was some criticism because the cost per job was excessive. I have heard some people say it cost as much as $100,000 per job. Some people say that the revision of the 956, I

guess, is maybe that expensive or more. I do not know.

I do know that we need to do some work on foreign taxation, both to be compliant with WHO and also just to bring our international tax laws up to date. I think that would be a more appropriate vehicle or train to work on this.

That would be my suggestion, not to be in total opposition to the Senator's proposal tonight, but to say, let us work on it, maybe in conjunction with more comprehensive international overseas tax changes.

Senator Santorum. Mr. Chairman?

Senator Conrad. Mr. Chairman?

Senator Nickles. The Senator from North Dakota.

Senator Conrad. Mr. Chairman, I want to join the Senator from Oklahoma and say to our colleagues, I would hope that we would not try to do that measure on this vehicle, at least at the committee level.

I have just recently had a number of conversations in which it has been suggested to me that there is a bigger bang for the buck in helping Puerto Rico than the 956 proposal that has been sent to us, and that, in fact, the cost per job of that proposal would be far in excess of the 936.

So, for those of us who have a Budget Committee perspective here as well, we need to have a full chance

to review all of the options so we are getting the best bang for the buck, the American taxpayers are getting the best bang for the buck.

Senator Nickles. I might mention, too, if we do not have this resolved by October, I would be happy to be with my friends from Louisiana and North Dakota and work on this in November, December, and January of next year.

Senator Breaux. It could take three months.

Let me just make a concluding comment, if I might. I do not want to push it to a vote. I mean, I think that this is something that we have to address. This is the Commonwealth of Puerto Rico.

These are U.S. citizens. As Senator Santorum said, they fight in wars, they die for America. They are Americans. We ought to be treating them better than we are third world foreign countries, many of which disagree with us on just about everything we do.

I mean, there have got to be some ways to help create jobs there. They are Americans and they are really hurting. We need to maybe have a hearing on this whole question of foreign tax credits, and this should be part of it.

Senator Santorum. Mr. Chairman?

Senator Nickles. I agree with my colleague from Louisiana.

The Senator from Pennsylvania?

Senator Santorum. I know this may sound nit-picky, but I actually would object to it coming up on the foreign tax credit. This is not a foreign country, this is America. We are doing a tax bill right now to help economic growth in America.

I sort of resent the idea that, somehow or another, we should look at Puerto Rico under the foreign tax provisions. They are not a foreign country. These are American citizens, many of whom come and live in your States and your communities, and go back and forth. So, again, I am not going to get wound up here. [Laughter].

Senator Nickles. Maybe I suggested the wrong vehicle. I appreciate my colleague's suggestion.

Senator Baucus. What are you like when you are wound up? [Laughter].

Senator Santorum. I just want to say to my colleague from Louisiana, I would support his attempt on this bill, if we can work out something with the Chairman.

Maybe there is an opportunity for us throughout the evening here to maybe find something that may be a placeholder or something that we could maybe work on later on the floor.

Maybe there is another vehicle around that is going

to pass where we can do this, but I do not feel comfortable allowing the situation in a very important part of our country to be left festering.

Everybody is here gnashing their teeth about 6 percent unemployment, and you have rates anywhere from 11 to 20 percent on the island of Puerto Rico. The fact is, they do not have any representative here and I think someone needs to speak up for them.

Senator Nickles. I appreciate my colleague, and I know, Senator Hatch. I might ask staff, have we even had a hearing on Puerto Rico tax provisions? I know that 936 is expiring. Have we considered various alternatives? The Senator from Louisiana suggested maybe we should have a hearing and discuss different approaches. Have we done that yet?

Mr. McClellan. No, Senator Nickles, we have not.

Senator Nickles. I think that would be a good suggestion.

Senator Hatch?

Senator Hatch. Well, let me just say this. I was a strong supporter of 936. Puerto Rico is a part of our country, but they have problems that the rest of the country does not have. I have to say that when we did 936, it attracted a lot of industry down to Puerto Rico and a lot of jobs. Now they have this high unemployment

because of what we have done.

Now, I agree you should not do it on this bill, probably, and I agree with the distinguished Senator from Louisiana. I will go along with that. But I think we have got to face this problem. It is not one that we can just ignore.

I am pleased to see that some of my colleagues are willing to face up to this problem, but I do not think we can let it go very long or these people are going to have even more unemployment than they have now.

It is not something that we have not discussed. Through every year I have been here, we have discussed it. I think we have got to have some sense about what we do to resolve the problems that we have helped to create, initially trying to be helpful, and now taking away these incentives, trying to allow them to exist on their own and we still have not come up with the answers on how we can help these people who are part of our country who have problems that the rest of the country does not have to the degree that they do. I am willing to work to work with the senior Senator from Louisiana, and everybody else, to try and get this done.

Senator Nickles. Senator Hatch, thank you very much.

I am going to call on Senator Lincoln for her

amendment. Senator Breaux, is that all right?

Senator Lott. Are we through on this amendment?

Senator Nickles. I think he is going to set it aside.

Senator Lott. If I could, just very briefly, before you go to the next one.

Senator Nickles. Senator Lott?

Senator Lott. I just want to say that, under the circumstances, I understand and agree that the amendment should be deferred for now. I have not always been supportive of some of the efforts with regard to the Puerto Rican situation, but I think in this case they are being, frankly, penalized. We need to step up to the issue and try to find a way to be helpful to them.

When we have a recorded vote on this, I am going to vote for it. I just wanted that to be recorded for the record.

Senator Hatch. And so am I.

Senator Nickles. I might mention, I am chairman of the Taxation Subcommittee. If the full committee does not do it, I am happy to hold a hearing in the subcommittee to consider this, and other, alternatives.

I do not want to pass a bill that we find out costs, in subsidies, over $100,000 per job. Some have alleged this might be the case. So, we want to do something that

we would be proud of, not look back and say, I cannot believe it cost that much.

Senator Lincoln?

Senator Lincoln. I would like to call up, Mr. Chairman, my Amendment 137. This is the amendment that would accelerate the refundable portion of the current law of the child credit.

As my colleagues will remember, we worked together in 2001 to craft a package which would benefit families with children. I hope that we can continue that good work with the President, the Chairman, and the rest of the members of this committee to accelerate that portion of the 2001 tax bill which really helps the bulk of American families. We have extended the child credit in this package, and this is really simply accelerating the refundability of it.

I would just like to share with the committee, briefly--I know everybody wants to go home--everybody does different things during their breaks. I spent a good bit of time in Arkansas, out on the road. But I also spent a little bit of time with my other hat on that I wear.

I went shopping and I bought four pair of blue jeans for twin boys that are almost seven years old. I bought two sets of tennis shoes. I paid for our Little League

sign-up, as well as a new Little League outfit for two little boys.

I sent a check to the public school we attend for their school lunches for the next two months. I also put a check in the mail for a two-week summer athletic camp for both my boys. I spent a good bit of money over this spring break that we just had.

When I consider that both my husband and I are bringing income home, and with those two children and all of the things that we want them to see and do, I did not do anything exceptional. I did not send them on a trip to a fancy camp or a resort somewhere far away.

I did not buy them expensive clothes. I did it at K-Mart, I have got to tell you. [Laughter]. I made two visits, K-Mart and Wal-Mart. Yes, I went to both of them. I went to both of them. I definitely share. [Laughter].

But I have to say, when it comes to even Easter shoes, we did with last year's Easter shoes because they only had to wear them once and I knew they might hurt for a little bit. But the fact is, American families are facing these realities.

I do not know how many of you all in this committee go face some of those realities every day like I do, but I do. I think it is critical that we recognize how

important it is for every working family, not just those that pay income tax. They still have to do that. Their children grow, inch by inch, day by day, just like mine do. Let me tell you, when you go through those blue jeans like water, it is amazing.

I think it is really critical for us to look at how we can provide something in this tax package that is not only going to stimulate the economy, but do something for these working families.

So, I just encourage, Mr. Chairman and all of my colleagues. I look at my State, and 46 percent of Arkansans have an adjusted gross income of less than $20,000; 80 percent of them have an adjusted gross income of less than $50,000.

So, when we are talking about these working families, I think it is really critical that we give something to them that they can use and that they can be a part of in reinfusing the economy of this great country. I know that we can.

I know the package we are going to send out of committee is probably still going to have some challenges. It is still going to have some things that we can improve on.

I want to note, Mr. Chairman, my understanding is that we have added to this bill the deduction for

mortgage insurance, the refundability of the child credit, which we are doing right here, I hope, the advanced refunding for the school bonds specific for States with Supreme Court decisions, the Bunning-Lincoln amendment that we worked on, and the uniform definition of a child, which I worked with Senator Hatch on.

I believe there are still improvements that we can make, but I do think that we have moved this bill along in good fashion and with some good things.

Mr. Chairman, do you have a question?

The Chairman. What I would like to do, in order to accommodate the money that is necessary for an offset, I would like to put this amendment in the manager's package.

Senator Lincoln. As long as it is in there along with the rest of these things I have just named, I do not have a problem where you put it, as long as we know that the offsets are there and the refundability is going to be there for the working families.

The Chairman. All right.

Senator Rockefeller?

Senator Lincoln. Are we going to vote on it? Oh, you just put it in the manager's amendment.

The Chairman. We are going to vote on it when we accept the manager's package.

Senator Lincoln. All right. Thank you, Mr. Chairman.

The Chairman. Senator Rockefeller?

Senator Rockefeller. Thank you very much, Mr. Chairman. I have been waiting a long time for that, but then I have been absent a lot, too, so I should not complain.

I think it is important to note that Senator Lincoln did not do all that she wanted to do on this. I am saying that to the Chairman and to all of our colleagues. There is not any child that is going to get money that is not already getting it, under this amendment.

But, on the other hand, it is still a very good amendment and I am really glad it is in the manager's package because otherwise we would not be doing anything to help some of the folks you talked about in one of the more eloquent speeches that I have heard in a long time. It is typical of you.

Mr. Chairman, I want to bring up an amendment, followed by one other amendment, which is necessary because I know I am probably not going to win the first amendment.

But I have a moral obligation on the fact that, two years ago, 75 members of this Congress voted for FMAP and the Social Services block grant, and this year 80

members, including three-quarters of this committee, voted for it. It was a $30 billion effort in which at least half would be used for FMAP and the other would be used for, as I indicated, the Social Services block grant.

I am sorry, but I cannot tread on this one lightly. I do not think it was a free vote over two years. I do not look on it that way, I do not feel that way about it, and I do not think people are going to feel that way about it.

We just sort of pretend like we are doing this for the States. We are not doing this for States, we are doing this for the American people. States are pass-throughs. If somebody wants to bring up corruption, I will be glad to talk about that, because that is a phony issue, too.

But we have got these huge deficits in the States, and then we pretend, well, that is not going to affect the stimulus package, even as I indicated earlier today that the cigarette tax went up in our State, which is a dumb thing to do with Kentucky, Ohio, and Virginia in the sense that people just go across the border.

But it is all our governor could do to try and raise some money for Medicaid, which is called "children who need it" and "families and people who need it." Thirty-

eight States are facing these kinds of cuts.

So, I am not thrilled by the thought of a 1.7 million more Americans losing their health care coverage because we will not take action at this level. Yet, that is what we are faced with.

So, I have a list here about what happened in different States. I will not do that, because members would be annoyed by that.

Medicaid is simply the underpinnings. We have certain moral obligations in this country and there are certain people that are born lucky, like I am, and there are certain people that do not have to worry about things, and there are certain people that do. Most people do, and most of them do not get elected to the Congress.

So, when we set out something like FMAP or Medicaid, we do that, in 1965, along with Medicare. We do that for a purpose because we say America does not always work for all people. Yet, if they are trying, we want to help them.

By the way, Mr. Chairman, it has enormous impact on our nursing homes and our hospitals. In West Virginia, there is not a hospital that does not have 85 percent of its revenue coming out of Medicaid and Medicare.

So, this is people, and these are our health care

institutions, which we are kind of blithely passing by. I do not want to insult anybody or anything of that sort, but I want to present the $30 billion, divided 15, for FMAP, which is Medicaid, directly to the States over the next year and a half, an enhanced match based on the match they already have.

The rest would go to the Social Services block grant, which is, in fact, health care and child care, and for a welfare reform bill, which we passed, or which we are passing, and will pass. We have done up to 40 hours a week, and we have no child care.

You cannot get child care in rural counties in West Virginia. You cannot get it in Arkansas, you cannot get it in Montana, and not in most places that are rural.

So, this is a heart-felt effort to try to help people that need it, and I recommend it to my colleagues and hope that they will vote for it.

The Chairman. Well, let me suggest a couple of things. One of them took place while the Senator had to be necessarily absent to be before the Armed Services Committee, and then another time that I had a discussion with Senator Baucus' staff, and Senator Baucus, and then in turn Senator Baucus' staff and my staff.

That is probably a reiteration of what I have said a couple of times already. That is, I hope this language

is flexible enough to accommodate you. If you are worried that there will not be any FMAP, there will be some FMAP.

Now, how much of the $20 billion will be FMAP, I do not know. But some of it will because there is a great demand, even among members of my party that some of it be FMAP. There is strong opposition in my party also to any of it being FMAP. There may be strong opposition in my part to State aid, generally.

But I do not know how you get the tax package, the stimulus package, past the U.S. Senate, both the first time, and even out of conference, without some money for State aid.

So, I guess I am saying, for a fifth time, including the report that we had while you were gone where we rewrote the language of our placeholder to make more clear what you wanted accomplished that I think I can help you accomplish.

I have got four or five pages here that says the same thing of exactly what I just told you, but I guess I would rather leave it the way I just said it.

So, I am not asking you to withdraw your amendment. There is a basis for your amendment. I probably was one of those 75 votes. I was one of those 80 votes that you referred to. But I do not think here is the place to do

it, nor do I believe that $30 billion is the figure we should use. So, I would ask people to vote against your amendment.

Senator Rockefeller. Mr. Chairman, I would ask for a vote. But I also want to inform the Chairman that, in the spirit of his efforts and sincerity, and against some of my own instincts, I am not going to offer the $20 billion FMAP amendment because that would cause some difficulties on the Chairman's side, and the Chairman already has that included in some form or ratio.

But I do have one clarification which is extremely important after this vote, which is very short, with respect to that.

Senator Smith. Mr. Chairman?

The Chairman. Senator Smith?

Senator Smith. Mr. Chairman, much of what Senator Rockefeller has said, I know I share. I know Senator Snowe shares as well. We both feel very strongly that, before we will vote on final passage on the Senate floor, FMAP is going to have to be part of this, and aid to the States is going to have to be part of it.

The Chairman. Or it will get probably about 47 votes.

Senator Smith. Yes. It will not have my vote. So, I truly believe that, before this is all said and done,

aid to the States and FMAP will be included. I think the votes are in place. So, whether it is germane or not, I cannot imagine, of the 80 that voted for this in the sense of the Senate, we cannot find 60 to vote for it still.

Senator Lott. Mr. Chairman?

The Chairman. Senator Lott?

Senator Lott. I have been withholding, not wanting to engage in this debate and delay our votes. So, I would inquire, what is the parliamentary situation? Are we going to have a vote on two or three amendments and then final passage?

The Chairman. Yes.

Senator Lott. Or are we going to continue to debate this issue?

The Chairman. No. I think there are just two amendments. We will vote on this amendment, and one more amendment he is going to offer. Senator Smith has one amendment.

Senator Smith. I have got two.

The Chairman. Two.

Senator Smith. They will be quick.

The Chairman. They will be quick. Then a manager's package, and then final passage.

Senator Lott. I do not want to further this debate

any more. I thought we worked out something we were going to try to live with out of this committee. But I am a little bit shocked by how gullible we are in the Congress.

I invite your attention to yesterday's *USA Today* article, not a paper I quote that much. But the headline is, "States Lament Fiscal Drought While Spending Up A Storm." They may be having deficits and budget problems, but they continue to have spending go up in most States. They have some deficits.

My State actually dealt with their deficit. Some States have $8.2 billion in deficit. We are going to have $300 or $400 billion in deficits. How can we be sending a check out to States that are still having their spending going up 7 percent, 8.2 percent, 8.1 percent, and even 4.9 percent last year?

I think they are laughing up their sleeves, the governors and the legislatures; do not worry, the Fed is going to write us a check.

So, I am willing to consider something in this area. I hope we will be very careful about how we set it up. I hope we will have some offsets for it and some reform. But I just think we are being taken for dupes here. You can argue that this would contribute to growth, but I do not believe it will.

At any rate, in view of what else has been said, I had to put down a marker that I think this is a really bad idea.

Senator Rockefeller. Mr. Chairman?

The Chairman. Senator Rockefeller?

Senator Rockefeller. Mr. Chairman, in that that speaks to my amendment, I wanted to be able to rebut it the best I can. I was a governor for eight years in a State which is not known for its wealth.

Actually, the facts are the following. States' average annual spending growth per resident increased by an average of 2 percent between 1989 and 1999. The average annual national spending per resident was 2.9 percent, almost a percent over that. From 1949 to 1990, it was also 2.9 percent.

The rainy day funds that States have set aside, fearing things which were going to happen, which indeed have happened since the recession in the early 1990s, is at a higher rate than it has been in 20 years. I do not accept that argument that was made.

Senator Baucus. Mr. Chairman?

The Chairman. The Senator from Montana.

Senator Baucus. I think the fact is, States' deficits are a lot higher primarily because their revenues are down. They are just not getting revenues.

It is the same reason that our federal revenue, that is, the Treasury, is getting a lot less than anticipated.

In addition, there are some increases in State spending, but I would daresay most of those are mandated in the sense that there are health care costs increases that everybody is facing, the Federal Government, the private sector, and so forth. They do have balanced budget requirements, most States do. So, this is not a simple question, but there are reasons why States are in tough shape.

The Chairman. The Clerk will call the roll.

The Clerk. Mr. Hatch?

Senator Hatch. No.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. No.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. No.

The Clerk. Mr. Frist?
Senator Frist. No.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. No.
The Clerk. Mr. Baucus?
Senator Baucus. Aye.
The Clerk. Mr. Rockefeller?
Senator Rockefeller. Aye.
The Clerk. Mr. Daschle?
Senator Daschle. Aye.
The Clerk. Mr. Breaux?
Senator Breaux. Aye.
The Clerk. Mr. Conrad?
Senator Conrad. Aye.
The Clerk. Mr. Graham?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Jeffords?
Senator Jeffords. Aye.
The Clerk. Mr. Bingaman?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Kerry?
Senator Baucus. Aye, by proxy.
The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 10 ayes, 11 nays.

The Chairman. Accordingly, the amendment is defeated.

Senator Rockefeller?

Senator Rockefeller. Mr. Chairman, in that the modification of the Chairman's mark was made, this is a new amendment. But, frankly, it is a very helpful amendment and it relates to what we have left, the $20 billion, however that works out.

It is what I call "the net amendment." This is the way it kind of works. The Chairman's mark now includes $20 billion in fiscal relief to the States. It also includes a dividend proposal that costs the States approximately $8 to $11 billion.

This amendment simply states that any fiscal relief to the States should be net of any costs imposed on the States by the provisions of the tax cut. In other words, States should be held harmless for revenues lost that they experienced due to the tax cuts passed by the Federal Government on this legislation. That is the basics.

The Chairman. All right. The other side of that coin, Senator Rockefeller, is Senator Lott, who, I do not know whether it was tongue-in-cheek or serious, suggested that if we were going to give State aid to States, we should not give it to any State that is increasing their taxes.

Here is what you are asking us to do. We passed federal tax legislation, and you are really blaming the Federal Government for our national tax policy of how it affects the States. We have got no control over how the States tax people.

If they are tied to the federal taxes and it brings in the result that you, maybe legitimately, say it brings in there, that is up to the States to make a determination whether or not they want to adjust their State tax policy to take into consideration the fact that the Federal Government has changed our tax policy.

That is our responsibility. They can take care of the problem you want to bring up through their own change of tax law. So, I think your plan is very unworkable.

But, even if it were workable, I do not think you can blame the Congress of the United States for some level of taxation or the tax policy of the States that have decided to tie their State income tax to federal income tax policy. So, I think we have to vote your amendment

down.

Senator Rockefeller. Mr. Chairman, may I just respond very briefly by saying, in fact, there are very few States that are likely to decouple from this change because it is administratively simpler to maintain conformity with the federal Tax Code, because in many States there are constitutional and/or political barriers to decoupling.

So, we have done a lot of talking here about mandating, and here we are taking money from the States because of something we are doing. I just think it is a perfectly fair proposal I am making.

The Chairman. Would the Clerk call the roll?

The Clerk. Mr. Hatch?

Senator Hatch. No.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. No.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?
Senator Santorum. No.
The Clerk. Mr. Frist?
Senator Frist. No.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. No.
The Clerk. Mr. Baucus?
Senator Baucus. Aye.
The Clerk. Mr. Rockefeller?
Senator Rockefeller. Aye.
The Clerk. Mr. Daschle?
Senator Daschle. Aye.
The Clerk. Mr. Breaux?
Senator Breaux. Aye.
The Clerk. Mr. Conrad?
Senator Conrad. No.
The Clerk. Mr. Graham?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Jeffords?
Senator Jeffords. Aye.
The Clerk. Mr. Bingaman?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 9 ayes, 12 nays.

The Chairman. Accordingly, the amendment is defeated.

Senator Smith?

Senator Smith. Thank you, Mr. Chairman.

My amendment concerns repatriation of the dollars of foreign subsidiaries. It costs $3.9 billion over 10 years. I would suggest that there are several ways of paying for this important amendment, and I hope to expand on how we pay for this on the floor.

But for now, it is necessary that I ask Joint Tax to modify my amendment to be consistent with the $2.4 billion revenue raiser from providing consistent amortization periods for intangibles. It is my intention, on the floor, to come forward with additional pay-fors, and that will amount to an additional $1.5 billion.

This amendment to repatriate foreign profits will have the effect of reducing the tax rates for one year,

from 35 percent to 5.25 percent, when we get all of the pay-fors in place.

I strongly believe that this is a temporary change--and I emphasize temporary, one year--that will immediately put earnings to work for the American economy.

Conservative estimates indicate that this bipartisan proposal will quickly inject $135 billion into the American economy, and in the first year put $4 billion into the U.S. Treasury. I actually think it will bring quite a bit more than that.

In order to qualify for the lower tax rate, companies must use these funds in this year for pro-growth, job-creating capital investments such as hiring, employee training, investments in infrastructure, research and development, and many other productive purposes that will stimulate growth and opportunity.

I, further, want to reassure members that this is a one-year window of opportunity and is meant to stay just a one-year window. I believe that we need to be clear about this, and I would support any report language or colloquy that would help to ensure this timeframe. We will oppose in the future any pressure to extend the provision beyond the year.

I am also confident that there will be no round

tripping. It makes no economic sense that, if the money is overseas and is not facing any taxes, why a U.S. corporation would bring it back at a 5.25 percent tax rate and then send it back out. Those funds will stay in the United States and be reinvested in ways that will expand the economy.

I want to say to my colleagues, I am open to consider legislative tweaks to this amendment to allay anyone's fears regarding round tripping, and I would ask for its adoption.

Senator Breaux. Mr. Chairman?

Senator Hatch. Mr. Chairman?

The Chairman. He just wants to put a statement in the record, before I call on Senator Hatch, and then I will go to you.

Senator Breaux. Thank you.

Senator Hatch. Mr. Chairman, I have a colloquy among yourself, myself, and Senator Smith that I would like to put in the record at this point. I am pleased with the remarks of Senator Smith, but this colloquy, I think, clarifies our position on this.

The Chairman. Without objection.

[The information appears in the appendix.]

The Chairman. Senator Breaux?

Senator Breaux. I may be missing something

terribly, but do you all remember, we were just talking about Puerto Rico, an American commonwealth, and we were talking about American companies that do business in Puerto Rico, with hiring American citizens, complying with all the laws of America with regard to minimum wage and environment, and we made a decision that we could not give those companies, when they bring money back to this country and invest it in this country, that we could not help them with the differential on the tax that they lose.

As I understand this amendment, we are making this provision available to U.S. companies that do business anywhere in the world and allowing them to bring this back with a tax break, and we are not doing the same thing for our American companies hiring American citizens in the Commonwealth of Puerto Rico? This does not gel with what we all said we could not do for the Commonwealth of Puerto Rico.

We are letting a U.S. company do business in a country we probably cannot even pronounce the name of, and are letting them bring back the profits, and do not even have a requirement that they invest it here in this country. That is not good policy. We did something for Puerto Rico with American citizens.

I mean, these companies are hiring foreigners and we

are giving them a tax break, countries that are not supportive of us, while the Commonwealth of Puerto Rico is our citizens and we cannot do it for them? To do this in France--I love France. I am French. But can they move to France and produce their products in France, and bring the profits back here and get a tax break?

Senator Smith. Mr. Chairman, if I may clarify.

The Chairman. Senator Smith?

Senator Smith. I think the Senator said that they did not have to bring the money back. Under this amendment, they have to bring the money back and invest it within the year to the advantage of the American people.

Senator Breaux. That was the same thing we proposed with Puerto Rico, with American citizens. Like I said, can they do it in Germany? Can they do it in Canada? Can they do this in Mexico? Can they do this in France under the gentleman's amendment?

Senator Smith. Yes.

Senator Breaux. Well, that is not good policy.

Senator Rockefeller. Mr. Chairman?

Senator Breaux. It is bad politics.

The Chairman. Who called? Senator Rockefeller.

Senator Rockefeller. I agree with Senator Breaux. The Joint Tax Committee has issued an opinion that this

would increase repatriations by $135 billion. Off the top of the head, that sounds good.

But the net effect is that this proposal amounts to a tax break for companies that decide to build factories in China instead of South Dakota, West Virginia, Louisiana, Iowa, all kinds of other States. That is exactly what it does.

We have 8 million unemployed Americans and I just do not understand how we contemplate providing a tax break for foreign investment that will encourage American companies to invest overseas.

Senator Bunning. Mr. Chairman?

The Chairman. Senator Bunning?

Senator Bunning. Mr. Chairman, first of all, on the Puerto Rican situation, I happened to be on the Ways and Means Committee when 936 was jettisoned. It was jettisoned because of the cost to the American people.

This is not a cost to the American people because there is nothing required that these companies bring their money back now. We are giving them an opportunity to bring it back now.

We are giving them an incentive to bring it back now so they can reinvest the money in the United States of America. They keep the money in Germany, or China, or wherever their company is now, and we get none of it.

This is an incentive to bring the money back so we can create jobs in the United States of America. That is the whole idea.

But if you say, no, that is fine. The simple reason is, we are doing this to help the United States, incentivize the American companies that have foreign subsidiaries, to bring the money back to the United States.

We are giving a one-time, one-year break, and give that chance for all this money--you talked about it, Senator Rockefeller--to come back. Otherwise, it is going to stay in the countries where the companies now have their subsidiaries. So, it is very, very important that we try to pass the Smith amendment.

Senator Santorum. Mr. Chairman?

The Chairman. Senator Santorum?

Senator Santorum. Thank you. As someone who is a very strong supporter of the Puerto Rico provision, I just want to echo what the Senator from Kentucky said.

The people who made these investments in foreign countries made these investments, not contemplating that there would be any opportunity to bring these revenues back at a reduced rate. They made them for a variety of different economic reasons.

If you want to allow the money that is made by XYZ

International Company in China to stay in China to build more plants, then keep the tax rate at 31 percent and they will build more plants in China and they will make more money in China, and they will develop their business in China.

If you want those revenues, that income, to come back to America so they can reinvest in this country and build plants, then you create an incentive for them to take the revenue and the income that they made in China, or in France, or any other country, and you give them incentive to bring it back here and you make them invest it in job creation in this country.

If there was a situation where there was an anticipation that this was going to be the case and that is the reason they invested the money in the first place, because they thought they were going to bring it back here at a tax rate reduced, that would be one thing. But that is not the case.

The case is, the money has been made. The money is sitting over there. We are never going to get access to it because it is inefficient for them to bring it here at the high rates of taxation.

So, in a sense, we are encouraging them to keep their money overseas, invest that money overseas, create more jobs overseas, to the detriment of this country.

Look, as someone who has lost a heck of a lot of jobs, as has the Senator from West Virginia, as someone who has lost a heck of a lot of jobs out of Pennsylvania for companies going overseas for cheaper labor, I am not happy that that happened.

But I tell you what, I would like to get some of that money they made back here into my State to build new jobs in my State, and that is what I think this accomplishes. If I am wrong, I would be happy to hear my colleagues' arguments as to the contrary.

The Chairman. Senator Conrad, then Senator Nickles. Then I would like to vote, if we could.

Senator Conrad. Mr. Chairman and colleagues, my understanding of this amendment is, currently we have given encouragement in our Tax Code for companies to go abroad to invest.

Now we would be saying, instead of facing a tax of 35 percent when you bring that money home, that would be reduced, for one year, to 5.25 percent. Then it would go back up to 35 percent.

Now, people can say it would be for one year only, but I know that is what our colleagues on the other side were saying about the previous tax cut that had all these sunsets in it.

Now what you say, is if you do not do away with the

sunset, it is a tax increase. So, hey, fool me once, shame on me. Fool me twice, shame on you.

Now, to say that nobody is going to come back and say, when it goes back up to 35 percent, that is not a tax increase? We all know that that is the claim that is going to be made, because that is the claim that has been made.

For people to suggest there is no cost, why does it have to be offset? If there was no cost, you would not have to offset it. But there is almost $4 billion here of cost, and $4 billion of offsets asked for, and there are not offsets provided.

They are supposed to be magically conjured up by somebody else. The person offering the amendment has not come up with the responsibility to offset the amendment. He instructs somebody else, you come up with the offset. Boy, that is convenient.

I have got a whole lot of amendments I would like to offer out here that cost money, and tell somebody else to come up with the offset. I tell you, our system has really broken down if that is the way we pass amendments in the Finance Committee, somebody else comes up with a way to pay for it.

The Chairman. Senator Nickles?

Senator Nickles. Mr. Chairman, I think there is

some merit in our colleague's proposal, but I am a little concerned about it. I think my arguments on Puerto Rico, saying we should maybe have hearings and we should do a foreign tax bill, we have been saying for about four years we are going to do a bill on foreign tax.

We have so many inequities right now, and this should be part of it. I do not doubt, if the Senator from Oregon says there is $135 billion that might be coming back into the country, if that happened, it would generate more than the so-called $4 billion.

But I also will tell you, from being a manufacturer, if you did it once--and you say this is a one-year window--you said you must do such and such, you must invest it, I would not want somebody telling me what I had to do with the money I was bringing back in.

I do not like that portion. I also do not like the one year. I would like to do something permanent that would really encourage investment and jobs.

So, I would hope that we would postpone this and take an overall look at international tax. I do not know. Does the administration have a position on this particular bill?

Mr. Jenner. No direct position, Senator, although we have strongly advocated comprehensive international reform in the past.

Senator Nickles. My real hesitation, though, is if we do it once, if I am an international manufacturer and I am still generating money and I am bringing it back and the tax is a one-time 5 percent, I am not going to bring any back for some time because I think Congress is going to do it again.

I think it probably would be successful for that one year, so you would have an infusion for one year, but the second through the eighth year, until we did it again, would probably dry up significantly, and then we would do it again.

I would like to have our Tax Code be a little more permanent, a little more constant, a little more well-thought-out overall, maybe as more of a comprehensive international tax change.

The Chairman. Senator Baucus?

Senator Baucus. Mr. Chairman, this discussion points out the need for international tax reform. It is a mess right now and obviously it is very complicated.

I am going to support this amendment, but I think the Senator from Oklahoma makes a very, very good point. That is, one year is hard to maintain.

But I think, in the interim, this year and next, we have a huge obligation in this committee to have a pretty extensive hearings that dig deeply into our international

tax structure, particularly compared with that of other countries, because we want to be competitive, we want to do what is right by American companies.

It is also difficult to argue in favor of this amendment, in the sense that we are basically saying to American companies, small American companies, you do not get this break, but if you are a big company and you have overseas operations, you pay less in corporate income taxes.

That is the heart of the argument against this amendment. I understand the repatriation argument, it brings dollars home. That is good. Hopefully it gets reinvested.

I think there are some new provisions in the modified amendment offered by the Senator from Oregon which is geared to better assure that the dollars are, in fact, reinvested here in America, and that is very good and that is one of the reasons I am going to support the amendment.

But, deep down, this whole discussion points that we are getting ourselves in more and more of a pickle in international taxation and it behooves us to try to straighten it out pretty quickly.

Senator Smith. Mr. Chairman?

The Chairman. I want to make clear. Could the

Senator from Oregon make clear how this is paid for? Because it is paid for, and I would like to have Senator Conrad know that.

Senator Smith. We have offsets at this point of $2.4 billion. What I am saying is, the rate would be reflected accordingly. It would probably take the rate, at this point, to 15 percent. I am just calculating that in my head.

My hope is to have the full $4 billion offset by the time we are to the floor so it can be further amended to get the rate to 5.25 percent. I do not dispute the need for maybe some overall corporate tax reform. But the truth of the matter is, I thought we were trying to get some stimulus. This is direct stimulus.

This directly creates jobs. This brings dollars back to this country in ways that we cannot just manufacture them in government. They are out there. We can bring them back, we can incentivize that, and we can direct their investment in this country.

Senator Breaux. Mr. Chairman?

The Chairman. Yes, sir.

Senator Breaux. I would just ask a parliamentary question. Does the Chairman intend to have a vote on this?

The Chairman. I would like to have a voice vote,

yes.

Senator Breaux. Oh, no, no. We want a record vote.

The Chairman. All right.

Senator Breaux. If we have a vote, I have an amendment to the gentleman's amendment.

The Chairman. Your amendment would be in order. Proceed.

Senator Breaux. I would like to offer an amendment that simply adds the Commonwealth of Puerto Rico to the gentleman's amendment. That is my amendment.

The Chairman. Those in favor of the Breaux amendment, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[A chorus of nays]

Senator Breaux. I would like a record vote, please.

Senator Santorum. Mr. Chairman, I am trying to understand the consequences of adding the Commonwealth of Puerto Rico to this.

Senator Breaux. American citizens who are employed by companies in Puerto Rico would have the exact same advantage in bringing those monies back to the mainland United States as any other country that is affected by the Senator from Washington's amendment.

The Chairman. I have to ask Mr. Yin the cost of

this amendment.

Senator Breaux. I want to use the same offsets he is using. [Laughter].

Mr. Yin. Mr. Chairman, we do not have an exact number because, to some extent, it would overlap the underlying amendment that has been offered. So, we do not have a precise number to know how much additional cost would be to the amendment by Senator Breaux.

Senator Breaux. I would ask counsel, you could adjust the rate just like the Senator from Washington suggested.

Senator Smith. Oregon.

Senator Breaux. I mean, from Oregon. Excuse me. Depending on what the offsets added up to.

The Chairman. You do not even have a ballpark figure for us?

Senator Lott. While they are talking, Mr. Chairman, do we have one more amendment after this, and then final passage?

The Chairman. One more amendment. Yes. Yes. I hope.

Senator Santorum. Mr. Chairman?

The Chairman. Who is asking for the floor? Senator Santorum?

Senator Santorum. I would love to support the

Senator from Louisiana. I am just trying to understand how this works. I mean, this is a repatriation of foreign income by corporations.

Corporations in Puerto Rico pay taxes in America. So, I am just trying to understand how this benefits people who do business in Puerto Rico by bringing things to the country they already pay taxes in. I do not get how this is helpful.

Senator Breaux. I do not know if you are asking counsel or me.

Senator Santorum. Are you just trying to say you are lowering the corporate tax rate for Puerto Rico to 15 percent? Is that what we are doing?

Senator Breaux. No. What we are doing, is giving the people that have businesses in Puerto Rico, when the money is being repatriated back----

Senator Santorum. But there is no repatriation. Repatriation means it is coming from a foreign country. This is the same country.

Senator Breaux. Counsel, can you comment on when this comes back to the United States, the tax that they pay offsets the tax break they get in Puerto Rico, so in effect they get no tax break at all? My intent by this legislation is to give them the same break that that company, if it did business overseas, would get.

Mr. Yin. Senator Breaux, certain companies operating in Puerto Rico would be treated like foreign companies now, so it would be essentially the same situation.

In terms of the question you asked about the ballpark figure, it would be in the range of about $6 billion for the two together instead of just the $3.8 billion. In terms of adjusting the rate, that we do not know, because at some point if you adjust the rate, then you take away the incentive to bring the money back. If you do that enough, then obviously it does not raise the money that you would need.

Senator Breaux. No. I was just following the Senator from Oregon's suggestion on the adjustment of the rate depending on what the offset added up to.

Senator Conrad. Mr. Chairman? Mr. Chairman?

The Chairman. Yes.

Senator Conrad. Have we ever had a hearing on the subject of this amendment? Have we ever had a hearing in the Finance Committee on this subject?

The Chairman. I do not know that we have.

Senator Conrad. If we are going to lower the corporate rate on money returned to the country from abroad to 5 percent, why would we not lower all corporate taxation to 5.25 percent?

Senator Nickles. We might be able to make a deal here.

Senator Conrad. Now you are talking. [Laughter].

Senator Hatch. Boy, would that incentivize our country, I will tell you. You have good ideas.

Senator Conrad. And while we are at it, I wonder if it would not be useful to lower the individual income tax rate to 5.25 percent. [Laughter].

Senator Hatch. Now you are really talking.

Senator Conrad. I mean, we are putting this country deep in deficit. Let us go whole hog!

The Chairman. All right. I think that we should have a vote on the amendment to the amendment. He asked for a roll call vote, so would the Clerk call the roll?

The Clerk. Mr. Hatch?

Senator Hatch. Aye.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. I hope we finish quickly before we slip into further amendments of this type. Aye.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. Aye.

The Clerk. Mr. Frist?

Senator Frist. Aye.

The Clerk. Mr. Smith?

Senator Smith. No.

The Clerk. Mr. Bunning?

Senator Bunning. No.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Rockefeller. Aye.

The Clerk. Mr. Daschle?

Senator Daschle. Aye.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Baucus. Pass.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Baucus. Pass.

The Clerk. Mr. Kerry?

Senator Baucus. Pass.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. Aye.

The Clerk. Mr. Chairman, the tally is 12 ayes, 6 nays, 3 passes.

The Chairman. The Breaux amendment to the amendment is adopted. I would ask for a voice vote on the Smith amendment. Those in favor of the Smith amendment, say aye.

Senator Conrad. No. I would ask for a roll call, Mr. Chairman.

The Chairman. All right. Call the roll.

The Clerk. Mr. Hatch?

Senator Hatch. Aye.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. Aye.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. Aye.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. Aye.

The Clerk. Mr. Frist?

Senator Frist. Aye.

The Clerk. Mr. Smith?

Senator Smith. Aye.

The Clerk. Mr. Bunning?

Senator Bunning. Aye.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Rockefeller. No.

The Clerk. Mr. Daschle?

Senator Daschle. No.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. No.

The Clerk. Mr. Graham?

Senator Baucus. No, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. No.

The Clerk. Mr. Bingaman?

Senator Baucus. No, by proxy.

The Clerk. Mr. Kerry?

Senator Baucus. No, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. No.

The Clerk. Mr. Chairman?

The Chairman. Aye.

The Clerk. Mr. Chairman, the tally is 10 ayes, 11 nays.

The Chairman. The amendment is defeated.

Senator Smith, you had one more amendment?

Senator Smith. Mr. Chairman, I am pleased to have Senator Lincoln join me on an issue of making mortgage insurance deductible. It is Smith Amendment Number 6. I thank Chairman Grassley for help in making this amendment possible. I understand that since it is paid for, it will be accepted.

Would you like me to further describe the amendment, Mr. Chairman?

The Chairman. Those in favor, say aye.

[A chorus of ayes]

The Chairman. Opposed, no.

[No response]

The Chairman. The amendment is obviously adopted.

We have the manager's amendment that has been agreed to between Senator Baucus and Senator Grassley. Is there any objection to the adoption of that amendment?

[No response]

The Chairman. Without objection, that amendment is adopted.

I now ask that the Chairman's mark, as amended, be adopted. Those in favor, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[A chorus of nays]

The Chairman. The ayes seem to have it. The ayes do have it. The amendment is adopted.

I now ask that the committee favorably report S.2, the Job and Growth Act of 2003. I would ask for the yeas and nays.

The Clerk. Mr. Hatch?

Senator Hatch. Aye.

The Clerk. Mr. Nickles?

Senator Nickles. Aye.

The Clerk. Mr. Lott?

Senator Lott. Aye.

The Clerk. Ms. Snowe?

Senator Snowe. Aye.

The Clerk. Mr. Kyl?

Senator Kyl. Aye.

The Clerk. Mr. Thomas?

Senator Thomas. Aye.

The Clerk. Mr. Santorum?

Senator Santorum. Aye.

The Clerk. Mr. Frist?

Senator Frist. Aye.

The Clerk. Mr. Smith?

Senator Smith. Aye.

The Clerk. Mr. Bunning?

Senator Bunning. Aye.

The Clerk. Mr. Baucus?

Senator Baucus. No.

The Clerk. Mr. Rockefeller?

Senator Rockefeller. No.

The Clerk. Mr. Daschle?

Senator Daschle. No.

The Clerk. Mr. Breaux?

Senator Breaux. No.

The Clerk. Mr. Conrad?

Senator Conrad. No.

The Clerk. Mr. Graham?

Senator Baucus. No, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. No.

The Clerk. Mr. Bingaman?

Senator Baucus. No, by proxy.

The Clerk. Mr. Kerry?

Senator Baucus. No, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Clerk. Mr. Chairman?

The Chairman. Aye.

The Clerk. Mr. Chairman, the tally is 12 ayes, 9 nays.

The Chairman. Would you announce that again, please?

The Clerk. Mr. Chairman, the tally is 12 ayes, 9 nays.

The Chairman. The bill is favorably reported.

I would further ask that the staff have the authority to draft necessary technical and conforming changes to the Chairman's mark. This drafting authority would include changes to ensure compliance with the committee's reconciliation instructions.

Without objection, so ordered.

The committee is adjourned.

[Whereupon, at 7:02 p.m. the meeting was concluded.]

I N D E X

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Senate Finance Committee
Colloquy among Chairman Grassley, Senator Hatch, and Senator Smith
regarding the Smith Amendment
"Repatriation of Earnings From Foreign Subsidiaries"
May 8, 2003

Senator Hatch: Mr. Chairman, I applaud my good friend from Oregon for offering this amendment to provide an incentive to U.S. multinational companies to repatriate earnings from their foreign subsidiaries. Our current system of taxing multinational companies can produce some perverse results. While I believe our system of deferring taxation of profits earned in foreign subsidiaries until those earnings are returned to the U.S. parent corporation is a good policy, it can encourage companies to keep their profits offshore. This has resulted in billions of dollars being "parked" overseas, and can discourage these companies from investing and growing at home. I am convinced that Senator Smith's proposal has the potential to bring billions back to the U.S. And a lot of that money will be used to put people

back to work here in the U.S. making machinery and software.

I do have a tax policy concern I would like to mention in connection with the amendment. I understand that Senator Smith's proposal provides the lower incentive tax rate on repatriated dividends for only one year, and then the current tax rate would again apply. As I mentioned, I think this provision will prove to be a strong incentive of which many companies will take full advantage. I am concerned, however, about what happens after the year is up. Will there be pressure placed on Congress to extend the provision beyond a year, or even to make it a permanent part of the tax code? Or, after the expiration of the provision, will multinational corporations hesitate to bring back overseas earnings in anticipation of another temporary incentive period in a few years? While I do not believe that is the intent of this proposal, I fear that either extending the proposal or allowing it to come back

will do serious damage to our international tax system, effectively overturning our current system of deferral, and giving companies even more incentive to ship their cash overseas.

Chairman Grassley: Senator Hatch, thank you for sharing your thoughts on this subject. And Senator Smith, I want to thank you for your hard work on this issue. I like the idea behind Senator Smith's legislation. If we can get companies to bring hundreds of billions of dollars from overseas and invest it here, that will help us grow jobs here in the U.S. And that is just what we need right now. However, I understand and agree with Senator Hatch's concerns. Senator Smith, do you think of your proposal as a one-time incentive or the beginning of a new way to tax multinational businesses?

Senator Smith: Mr. Chairman, I completely agree with Senator Hatch that this proposal should be enacted once

and only once. As I worked with a number of our colleagues to develop this legislation, we always assumed this would be a one-time-only opportunity. In fact, the provision will be a much stronger economic incentive if it is available only for one limited period. When companies realize that this is their one-and-only chance to bring their profits back home, I think they will flood this country with overseas profits. And once they bring the money back, they will use that money to buy equipment, hire new workers, and pay down their debt.

Chairman Grassley: Senator Smith, thank you for that assurance. I agree with the Senator from Oregon that this bill only works if we make it a one-time-only opportunity. If this provision becomes law, I will say right here that at long as I am Chairman of this Committee, we will not consider extending or re-enacting this provision. Senator Smith, will you join me in this commitment to oppose any attempts to extend this proposal or to resurrect it in a few

years?

Senator Smith: Yes, Mr. Chairman, I completely concur with you and I join you in your commitment to oppose any attempt to extend this provision or bring it back later.

Chairman Grassley: I thank the Senator from Oregon and now ask Senator Hatch if this addresses his concerns?

Senator Hatch: Yes, Mr. Chairman. I thank my colleague from Oregon for explaining his views to me, and I thank him and the Chairman for their commitments to oppose any extension. This sounds like good growth policy as long as we do it just once, and it sounds as if that is exactly what you and my good friend from Oregon both want. With these assurances, I am happy to join my colleague from Oregon in voting for this amendment.

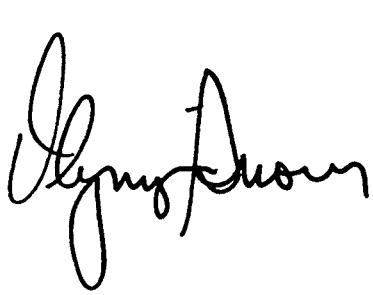
Chairman Grassley: Senator Smith, I would like to ask

one more question about your amendment. Some folks have raised concerns that companies might take advantage of the provision and use this low tax rate to bring profits from one foreign country into the U.S. and then just ship it out to another foreign country. Would you be willing to work with the committee to help us in drafting language to prevent this so-called "round-tripping?" I think that with your assistance we can tackle this important problem and make sure that this legislation does not become a tool for tax abuse.

Senator Smith: Mr. Chairman, I will be happy to work with your staff and Senator Baucus's staff to make sure that the provision as drafted does exactly what it is supposed to do – bring these earnings back to the U.S. to help our economy grow.

Senator Grassley: Thank you, Senator Smith.

Statement of Senator Olympia Snowe
Committee Markup
May 8, 2003



Mr. Chairman, I want to thank you for your leadership throughout this process as we worked to develop a growth package. I especially appreciate your willingness to work with Senator Smith and me to add a fiscal relief component, which I believe has *added value* to this economic stimulus package. As I have discussed on numerous occasions, I believe that one of the best stimulates for the economy is providing assistance to our state and local governments. And I am pleased to speak today in support of the fiscal relief proposal that has been included in the manager's amendment.

While the language included in the manager's amendment is simply a placeholder, I want to assure my colleagues, and the state and local leaders with whom I have been working, that the Senate will *in fact* include specific language for fiscal relief in the final tax package. However, recognizing that a number of Senators have been involved in the effort to secure funding for fiscal relief, it is only appropriate that we address this issue more specifically on the Senate floor. Chairman Grassley is committed to supporting a floor amendment to more specifically distribute the $20 billion. And I will support an amendment that provides part of the money to state and local governments through flexible grants, with the remaining portion provided through a temporary increase to the Federal Medical Assistance Percentage.

I am confident that with the Chairman's support and the willingness of my colleagues to work together, we can garner *more than* the 50 votes *required* to add fiscal relief to this growth package. After all, 80 Senators voted in favor of state and local fiscal relief during last month's budget debate.

As we all know, our states and local communities are struggling. For the past three years, while the economy has been in a downturn, they have worked to meet the needs of residents, while 49 out of 50 states – including Maine – are also required to balance their budgets. In fact, the National Conference of State Legislatures reports that since FY2001, the combined budget shortfall in states has totaled more than $200 billion. And the outlook for FY04 is not proving different. In January, 36 states reported budget gaps totaling more than $68 billion for this year alone. In Maine, the Governor and Legislature were forced to trim $1.2 billion from their biennial budget – in the wake of a $150 million shortfall in FY03.

Some argue state budget shortfalls result from overspending – yet a report issued by the National Governors Association shows that *state spending from 1995 to 2001 increased 6.5 percent per year, a rate identical to spending from 1979 to 2003*. Rather, it has been a drop in the stock market and the economy – concurrent with increased costs associated with necessities like elementary and secondary education...programs under the Individuals with Disabilities Education Act, or IDEA...homeland security...and Medicaid – that has been the real culprit in burdening state and local budgets.

The National Conference of State Legislatures has reported a *substantial* decline in projected revenue, including drops in income, sales and property tax receipts, and user fees. Indeed, data suggest that over *three-fourths* of the combined state budget shortfall is due to declines in state revenues. Again, unlike the federal government, state's don't have the option of running deficits – and after three years, most practical belt-tightening measures have already taken effect.

On the *spending* side, the NCSL estimates that unfunded mandates for the policy areas I just mentioned account for up to *$82 billion* in increased expenses. And states rightly argue that the vast majority of their increased cost burden comes from the growing unfunded federal mandate for providing care to the elderly and disabled. Medicaid provides access to health care for almost 43 million of America's poor, elderly and disabled citizens and it *alone* is a program for which costs have grown by 11.1 percent from 1990 to 2000.

Because of benefit shortfalls in the Medicare program – such as a prescription drug benefit – Medi*caid* ends up providing *more* vital services. Indeed, while seniors and the disabled represent only one-quarter of the Medicaid population, they account for almost three-fourths of all Medicaid expenses. For example, in fiscal year 2002 states provided *$6.9 billion* in prescription drug assistance to Medicare beneficiaries, and another *$5.5 billion* in copayment and premium assistance.

That's why providing fiscal relief is so critical – because while there's no *question* this population needs to be served, there should also be no doubt we can't leave states to be the last line of defense in footing the bill.

It's the same with issues like education – and that's why I also support providing flexible funding for states and localities to use as they see fit. In California 20,000 teachers are at risk of being laid off, in New York local districts are raising property taxes to offset the expected four percent cut in state education aid, and in Nebraska officials have told 1,000 students that their academic scholarships to state universities are being canceled and 431 college positions were eliminated. We're making such great advances in education – and we all know that education is the key to our future economic success. By providing fiscal relief, the federal government is continuing its commitment.

Of course, the level of assistance that Congress can provide would not *eliminate* any state's total budget shortfall. But it *would* provide vitally important assistance and I believe will gain the endorsement of the largest state and local associations that represent our country's local elected representatives and leaders. Moreover, providing this state and local fiscal assistance within the tax package is *entirely* in keeping with our efforts to stimulate the economy.

According to a recent *Wall Street Journal* article, "Analysts at Goldman Sachs figure state and local belt-tightening will shave as much as a half-point from the economy's growth so that overall fiscal policy will be no more than neutral next year." After all, dollars spent on education, health care *and transportation* have an economic value today *and* tomorrow.

In fact, the U.S. Chamber of Commerce reports that for every $1 billion invested in transportation, 47,500 new jobs are created. And let us not forget that state and local governments account for more than 15 million jobs nationwide. As we take steps to put more money into the hands of consumers, we must also make sure that those who are employed by a state or local government, either directly or through a government service contract, are able to *stay* employed.

Mr. Chairman, I applaud your leadership on this issue. I also would like to thank my colleague from Oregon, Senator Smith, for his work on behalf of state and local governments. Providing short-term fiscal relief to help state and local governments balance their budgets is vitally important to the long-term viability of our economy.

Thank you Mr. Chairman.

Olympia Snowe

INTRODUCTORY STATEMENT
SENATOR OLYMPIA J. SNOWE
AMENDMENT ON
SMALL BUSINESS INVESTMENT COMPANY CAPITAL ACCESS ACT OF 2003
MAY 8, 2003

Mr. Chairman, I offer as an amendment to the "Jobs and Growth Tax Act of 2003" the "Small Business Investment Company Capital Access Act of 2003," which I introduced earlier this year. The purpose of this amendment is to improve access to capital for small businesses through the Small Business Investment Company (SBIC) program. I am pleased that you are one the original co-sponsors of this legislation.

In the previous two years, the private-equity market has undergone a significant contraction. During this same period, the Small Business Administration's (SBA) SBIC program has taken on a significant role in providing venture capital to small businesses seeking investments in the range of $500,000 to $3 million.

Small Business Investment Companies are government-licensed, government-regulated, privately managed venture capital firms created to invest only in original issue debt or equity securities of U.S. small businesses that meet size standards set by law. In the current economic environment, the SBIC program represents an increasingly important source of capital for small enterprises.

While Debenture SBICs qualify for SBA-guaranteed borrowed capital, the government guarantee forces a number of potential investors, namely pension funds and university endowment funds, to avoid investing in SBICs because they would be subject to tax liability for unrelated business taxable income (UBTI). More often than not, tax-exempt investors opt to invest in venture capital funds that do not create UBTI. As such, an estimated 60% of the private-capital potentially available to these SBICs is effectively "off limits."

The "Small Business Investment Company Capital Access Act of 2003" would correct this problem by excluding government-guaranteed capital of Debenture SBICs from debt for purposes of the UBTI rules. This change would permit tax-exempt organizations to invest in SBICs without the burdens of UBTI record keeping or tax liability.

As a result, this amendment would increase small business' access to capital, enabling them to grow and hire new employees. According to the

National Association of Small Business Investment Companies, a conservative estimate of the effect of this amendment would be to increase investments in Debenture SBICs by $200 million per year from tax-exempt investors. Together with SBA-guaranteed leverage, that will mean as much as $500 million per year in new capital assets for Debenture SBICs to invest in U.S. small businesses.

This increased access to capital is critical because according to the SBA, one job is created for every $36,000 invested in a small company. At that rate, this amendment has the potential to create as many as 16,600 jobs, both in companies that receive investments directly as well as in those firms that benefit indirectly through increased sales of goods and services to the former companies. In short, this bill is a jobs creator!

And the cost for implementing this change is rather minimal when compared to benefits it will provide. According to the Joint Committee on Taxation for the last Congress, this amendment would decrease tax revenues by only $1 million per year for the next ten years.

Mr. Chairman, the cost of this amendment is low while the potential for economic growth is great. Passing this amendment will make the federal government's existing SBIC program more effective in providing growth capital for America's small business entrepreneurs.

Moreover, this amendment will provide much-needed capital for the sector of our economy that provides a majority of the net new jobs in this country- small businesses. This amendment is a true stimulus to our economy that would produce new investments and ultimately create new jobs, something that our economy desperately needs. Small business owners and the American people deserve this type of stimulus, and I therefore urge my colleagues to support this important amendment.

JOBS AND GROWTH ACT OF 2003
SENATE FINANCE COMMITTEE MARK-UP
STATEMENT OF SENATOR RICK SANTORUM
MAY 8, 2003

Chairman Grassley, thank you for calling this meeting today of the Senate Finance Committee to consider the Jobs and Growth Act of 2003. I think today represents a positive and significant step forward towards accomplishing the President's goal of reinvigorating our economy through a strong tax relief package with the dual priorities of creating more jobs in the short-term and reinforcing our economic foundation for the long-term.

First, I would like to thank Chairman Grassley for his diligence and tenacity in bringing us to this point. He was determined to find a common ground for Members of this committee to support a strong economic growth package, and that was no easy task. The product that the Chairman will offer today in his modification package reflects a constructive process but challenging task of arriving at the shared goal of a growth package with consensus.

To start, the proposal aims to re-charge the economy on many levels. The package offers tax relief across-the-board through acceleration of income tax rate reduction; it addresses the standing issue of the marriage tax penalty; small businesses will be able to make greater capital investment in their businesses through increased expensing provisions; and the fundamental change of dividend tax relief will go far to reduce the cost of capital and savings.

Let me be clear, to arrive at this point meant that almost everyone had to sacrifice something. I have been fully supportive of a dividends exclusion proposal that would *fully* eliminate the double tax penalty. While there has been much dialogue about the intended benefits of a dividend exclusion proposal, both short- and long-term effects, I think the concept is bold and beneficial.

Eliminating the double tax on dividends carries forward the sound idea that income should only be taxed once. This is a fundamental, but significant, change from current practice which taxes income through dividends twice. Over time, this has created a more favorable climate for debt financing versus equity in the world of business. At its very core - a dividend exclusion proposal would modify this perverse incentive for a business to accumulate debt rather than offer a return to the shareholder. What this boils down to in the end is making available increased capital for new expenditures and investments, and that equals jobs.

I would like to share an additional concern with the Chairman about any dividend exclusion proposal that we may consider. In the original mark, the dividend provision - in my estimation - did not extend the elimination of the double tax on dividends to variable annuity products. For example, policyholders of variable annuity products would still be subject to the second level of taxation on dividends that were allocated to the underlying equity product in their variable annuity.

Currently, a corporation pays a tax on its taxable income, generally at the rate of 35 percent. To the extent that a corporation distributes its after-tax earnings and profits as a dividend through a variable annuity to an annuity policyholder, when payments are made from the annuity, the policyholder includes the amount of the dividend in gross income and pays tax at the policyholder's individual tax rate.

Under present law, corporations receiving dividends from domestic corporations generally are allowed a deduction of 70 percent or more of the amount of the dividends received. However, for life insurance companies, this deduction is allocated ("prorated") between the insurer and the policyholder.

Similar to the original proposal offered by the Administration, the Jobs and Growth Act of 2003 provides that a mutual fund shareholder will receive the benefits of excludable dividends. The Act, however, does not currently provide for variable annuity policyholders to receive any of these benefits. Dividends, whether paid through a mutual fund or through a variable annuity, should not be subject to a second level of tax; thus, the ability to pass through these benefits should also be available to variable annuity policyholders to the same extent as to mutual fund shareholders.

As we consider the modifications today, I look forward to a discussion regarding this real concern relative to variable annuities, and would like to continue working with the Chairman to address them in a responsible and fair manner.

Mr. Chairman, let me conclude by once again thanking you for your weeks of hard work that have led us to this mark-up. Additionally, you are to be congratulated for producing the package before us. Through our work here today, we are setting out on a clear path to reinvigorate the economy; create more jobs; and reinforce the economic foundation for our long-term security.

DESCRIPTION OF THE "JOBS AND GROWTH TAX ACT OF 2003"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on May 8, 2003

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

May 6, 2003
JCX-42-03

CONTENTS

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "Jobs and Growth Tax Act of 2003." The Senate Committee on Finance has scheduled a markup of this proposal for May 8, 2003.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Jobs and Growth Tax Act of 2003"* (JCX-42-03), May 6, 2003.

I. ACCELERATION OF CERTAIN PREVIOUSLY ENACTED TAX REDUCTIONS AND INCREASED EXPENSING FOR SMALL BUSINESSES

A. Accelerate Reductions in Individual Income Tax Rates

Present Law

In general

Under the Federal individual income tax system, an individual who is a citizen or a resident of the United States generally is subject to tax on worldwide taxable income. Taxable income is total gross income less certain exclusions, exemptions, and deductions. An individual may claim either a standard deduction or itemized deductions.

An individual's income tax liability is determined by computing his or her regular income tax liability and, if applicable, alternative minimum tax liability.

Regular income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income. This tax liability is then reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

For 2003, the regular income tax rate schedules for individuals are shown in Table 1, below. The rate bracket breakpoints for married individuals filing separate returns are exactly one-half of the rate brackets for married individuals filing joint returns. A separate, compressed rate schedule applies to estates and trusts.

Table 1.–Individual Regular Income Tax Rates for 2003

If taxable income is over:	But not over:	Then regular income tax equals:
	Single Individuals	
$0	$6,000	10% of taxable income
$6,000	$28,400	$600, plus 15% of the amount over $6,000
$28,400	$68,800	$3,960.00, plus 27% of the amount over $28,400
$68,800	$143,500	$14,868.00, plus 30% of the amount over $68,800
$143,500	$311,950	$37,278.00, plus 35% of the amount over $143,500
Over 311,950		$96,235.50, plus 38.6% of the amount over $311,950
	Head of Households	
$0	$10,000	10% of taxable income
$10,000	$38,050	$1,000, plus 15% of the amount over $10,000
$38,050	$98,250	$5,207.50, plus 27% of the amount over $38,050
$98,250	$159,100	$21,461.50, plus 30% of the amount over $98,250
$159,100	$311,950	$39,716.50, plus 35% of the amount over $159,100
Over 311,950		$93,214, plus 38.6% of the amount over $311,950
	Married Individuals Filing Joint Returns	
$0	$12,000	10% of taxable income
$12,000	$47,450	$1,200, plus 15% of the amount over $12,000
$47,450	$114,650	$6,517.50, plus 27% of the amount over $47,450
$114,650	$174,700	$24,661.50, plus 30% of the amount over $114,650
$174,700	$311,950	$42,676.50, plus 35% of the amount over $174,700
Over 311,950		$90,714, plus 38.6% of the amount over $311,950

Ten-percent regular income tax rate

Under present law, the 10-percent rate applies to the first $6,000 of taxable income for single individuals, $10,000 of taxable income for heads of households, and $12,000 for married couples filing joint returns. Effective beginning in 2008, the $6,000 amount will increase to $7,000 and the $12,000 amount will increase to $14,000.

The taxable income levels for the 10-percent rate bracket will be adjusted annually for inflation for taxable years beginning after December 31, 2008. The bracket for single individuals and married individuals filing separately is one-half for joint returns (after adjustment of that bracket for inflation).

Reduction of other regular income tax rates

Prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") the regular income tax rates were 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent.[2] EGTRRA added the 10 percent regular income tax rate, described above, and retained the 15-percent regular income tax rate. Also, the 15-percent regular income tax bracket was modified to begin at the end of the ten-percent regular income tax bracket. EGTRRA also made other changes to the 15-percent regular income tax bracket.[3]

Also, under EGTRRA, the 28 percent, 31 percent, 36 percent, and 39.6 percent rates are phased down over six years to 25 percent, 28 percent, 33 percent, and 35 percent, effective after June 30, 2001. Accordingly, for taxable years beginning during 2001, the rate reduction comes in the form of a blended tax rate. The taxable income levels for the rates above the 15-percent rate in all taxable years are the same as the taxable income levels that apply under the prior-law rates.

Table 2, below, shows the schedule of regular income tax rate reductions.

Table 2.–Scheduled Regular Income Tax Rate Reductions

Taxable Year	28% rate reduced to:	31% rate reduced to:	36% rate reduced to:	39.6% rate reduced to:
2001[1]-2003	27%	30%	35%	38.6%
2004-2005	26%	29%	34%	37.6%
2006 and later[2]	25%	28%	33%	35.0%

[1] Effective July 1, 2001.

[2] The reductions in the regular income tax rates are repealed for taxable years beginning after December 31, 2010, under the sunset of EGTRRA.

[2] The regular income tax rates will revert to these percentages for taxable years beginning after December 31, 2010, under the sunset of EGTRRA.

[3] See the discussion of the provision regarding marriage penalty relief in the 15-percent regular income tax bracket, below.

Alternative minimum tax

The alternative minimum tax is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is an amount equal to (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent of the remaining AMTI. The maximum tax rates on net capital gain used in computing the tentative minimum tax are the same as under the regular tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments. The exemption amounts are: (1) $49,000 ($45,000 in taxable years beginning after 2004) in the case of married individuals filing a joint return and surviving spouses; (2) $35,750 ($33,750 in taxable years beginning after 2004) in the case of other unmarried individuals; (3) $24,500 ($22,500 in taxable years beginning after 2004) in the case of married individuals filing a separate return; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Description of Proposal

Ten-percent regular income tax rate

The proposal accelerates the scheduled increase in the taxable income levels for the 10-percent rate bracket. Specifically, beginning in 2003, the proposal increases the taxable income level for the 10-percent regular income tax rate brackets for single individuals from $6,000 to $7,000 and for married individuals filing jointly from $12,000 to $14,000. The taxable income levels for the 10-percent regular income tax rate bracket will be adjusted annually for inflation for taxable years beginning after December 31, 2003.

Reduction of other regular income tax rates

The proposal accelerates the reductions in the regular income tax rates in excess of the 15-percent regular income tax rate that are scheduled for 2004 and 2006. Therefore, for 2003 and thereafter, the regular income tax rates in excess of 15 percent under the proposal are 25 percent, 28 percent, 33 percent, and 35 percent.

Alternative minimum tax exemption amounts

The proposal increases the AMT exemption amount for married taxpayers filing a joint return and surviving spouses to $57,000, and for unmarried taxpayers to $39,750, for taxable years beginning in 2003, 2004, and 2005.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

B. Accelerate Marriage Penalty Relief

1. Standard deduction marriage penalty relief

Present Law

Marriage penalty

A married couple generally is treated as one tax unit that must pay tax on the couple's total taxable income. Although married couples may elect to file separate returns, the rate schedules and other provisions are structured so that filing separate returns usually results in a higher tax than filing a joint return. Other rate schedules apply to single persons and to single heads of households.

A "marriage penalty" exists when the combined tax liability of a married couple filing a joint return is greater than the sum of the tax liabilities of each individual computed as if they were not married. A "marriage bonus" exists when the combined tax liability of a married couple filing a joint return is less than the sum of the tax liabilities of each individual computed as if they were not married.

Basic standard deduction

Taxpayers who do not itemize deductions may choose the basic standard deduction (and additional standard deductions, if applicable),[4] which is subtracted from adjusted gross income ("AGI") in arriving at taxable income. The size of the basic standard deduction varies according to filing status and is adjusted annually for inflation.[5] For 2003, the basic standard deduction for married couples filing a joint return is 167 percent of the basic standard deduction for single filers (Alternatively, the basic standard deduction amount for single filers is 60 percent of the basic standard deduction amount for married couples filing joint returns). Thus, two unmarried individuals have standard deductions whose sum exceeds the standard deduction for a married couple filing a joint return.

EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return.[6] The increase in the standard deduction for married taxpayers filing a joint return is scheduled to be

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[4] Additional standard deductions are allowed with respect to any individual who is elderly (age 65 or over) or blind.

[5] For 2003 the basic standard deduction amounts are: (1) $4,750 for unmarried individuals; (2) $7,950 for married individuals filing a joint return; (3) $7,000 for heads of households; and (4) $3,975 for married individuals filing separately.

[6] The basic standard deduction for a married taxpayer filing separately will continue to equal one-half of the basic standard deduction for a married couple filing jointly; thus, the basic standard deduction for unmarried individuals filing a single return and for married couples filing separately will be the same after the phase in period.

phased-in over five years beginning in 2005 and will be fully phased-in for 2009 and thereafter. Table 3, below, shows the standard deduction for married couples filing a joint return as a percentage of the standard deduction for single individuals during the phase-in period.

Table 3.–Scheduled Phase-In of Increase of the Basic Standard Deduction for Married Couples Filing Joint Returns

Taxable Year	Standard Deduction for Married Couples Filing Joint Returns as Percentage of Standard Deduction for Unmarried Individual Returns
2005	174
2006	184
2007	187
2008	190
2009 and later[1]	200

[1] The basic standard deduction increases are repealed for taxable years beginning after December 31, 2010, under the sunset provision of EGTRRA.

Description of Proposal

The proposal accelerates the increase in the basic standard deduction amount for joint returns to twice the basic standard deduction amount for single returns effective beginning in 2003.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

2. Accelerate the expansion of the 15-percent rate bracket for married couples filing joint returns

Present Law

In general

Under the Federal individual income tax system, an individual who is a citizen or resident of the United States generally is subject to tax on worldwide taxable income. Taxable income is total gross income less certain exclusions, exemptions, and deductions. An individual may claim either a standard deduction or itemized deductions.

An individual's income tax liability is determined by computing his or her regular income tax liability and, if applicable, alternative minimum tax liability.

Regular income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income and then is reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

In general, the bracket breakpoints for single individuals are approximately 60 percent of the rate bracket breakpoints for married couples filing joint returns.[7] The rate bracket breakpoints for married individuals filing separate returns are exactly one-half of the rate brackets for married individuals filing joint returns. A separate, compressed rate schedule applies to estates and trusts.

15-percent regular income tax rate bracket

EGTRRA increased the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for a single individual filing a single return. The increase is phased-in over four years, beginning in 2005. Therefore, this provision is fully effective (i.e., the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return is twice the size of the 15-percent regular income tax rate bracket for an unmarried individual filing a single return) for taxable years beginning after December 31, 2007. Table 4, below, shows the increase in the size of the 15-percent bracket during the phase-in period.

[7] The rate bracket breakpoint for the 38.6 percent marginal tax rate is the same for single individuals and married couples filing joint returns.

Table 4.–Scheduled Increase in Size of the 15-Percent Rate Bracket for Married Couples Filing Joint Returns

Taxable year	End Point of 15-Percent Rate Bracket for Married Couples Filing Joint Returns as Percentage of End Point of 15-Percent Rate Bracket for Unmarried Individuals
2005	180
2006	187
2007	193
2008 and thereafter[1]	200

[1] The increases in the 15-percent rate bracket for married couples filing a joint return are repealed for taxable years beginning after December 31, 2010, under the sunset of EGTRRA.

Description of Proposal

The proposal accelerates the increase of the size of the 15-percent regular income tax rate bracket for joint returns to twice the width of the 15-percent regular income tax rate bracket for single returns beginning in 2003.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

C. Accelerate the Increase in the Child Tax Credit

Present Law

In general

For 2003, an individual may claim a $600 tax credit for each qualifying child under the age of 17. In general, a qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is the taxpayer's son or daughter (or descendent of either), stepson or stepdaughter (or descendent of either), or eligible foster child.

The child tax credit is scheduled to increase to $1,000, phased-in over several years.

Table 5, below, shows the scheduled increases of the child tax credit.

Table 5.–Scheduled Increase of the Child Tax Credit

Taxable Year	Credit Amount Per Child
2003-2004	$600
2005-2008	$700
2009	$800
2010 and later[1]	$1,000

[1] The credit reverts to $500 in taxable years beginning after December 31, 2010, under the sunset provision of EGTRRA.

The child tax credit is phased-out for individuals with income over certain thresholds. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns.[8] The length of the phase-out range depends on the number of qualifying children. For example, the phase-out range for a single individual with one qualifying child is between $75,000 and $85,000 of modified adjusted gross income. The phase-out range for a single individual with two qualifying children is between $75,000 and $95,000.

The amount of the tax credit and the phase-out ranges are not adjusted annually for inflation.

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[8] Modified adjusted gross income is the taxpayer's total gross income plus certain amounts excluded from gross income (i.e., excluded income of U.S. citizens or residents living abroad (sec. 911); residents of Guam, American Samoa, and the Northern Mariana Islands (sec. 931); and residents of Puerto Rico (sec. 933)).

Refundability

For 2003, the child credit is refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,500.[9] The percentage is increased to 15 percent for taxable years 2005 and thereafter. Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of $10,500 (for 2003). The refundable portion of the child credit does not constitute income and isnot treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds.

Alternative minimum tax liability

The child credit is allowed against the individual's regular income tax and alternative minimum tax.

Description of Proposal

The amount of the child credit is increased to $1,000 for 2003 and thereafter. For 2003, the increased amount of the child credit will be paid in advance beginning in July 2003 on the basis of information on each taxpayer's 2002 return filed in 2003. Advance payments will be made in a similar manner to the advance payment checks issued by the Treasury in 2001 to reflect the creation of the 10-percent regular income tax rate bracket. The increase in refundability to 15 percent of the taxpayer's earned income, scheduled for calendar years 2005 and thereafter, is not accelerated by the proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

[9] The $10,500 amount is indexed for inflation.

D. Increase Section 179 Expensing

Present Law

Present law provides that, in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 (for taxable years beginning in 2003 and thereafter) of the cost of qualifying property placed in service for the taxable year (sec. 179).[10] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. An election to expense these items generally is made on the taxpayer's original return for the taxable year to which the election relates, and may be revoked only with the consent of the Commissioner.[11] In general, taxpayers may not elect to expense off-the-shelf computer software.[12]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.

Description of Proposal

The proposal provides that the maximum dollar amount that may be deducted under section 179 is increased to $75,000 for property placed in service in taxable years beginning in 2003 through 2012. In addition, the $200,000 amount is increased to $325,000 for property placed in service in taxable years beginning in 2003 through 2012. Both of these dollar limitations are indexed annually for inflation for taxable years beginning after 2003 and before 2013. The proposal also includes off-the-shelf computer software placed in service in a taxable year beginning in 2003 through 2012 as qualifying property. With respect to a taxable year beginning after 2002 and before 2013, the proposal permits taxpayers to make or revoke expensing elections on amended returns without the consent of the Commissioner.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002, and before January 1, 2013..

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[10] Additional section 179 incentives are provided with respect to a qualified property used by a business in the New York Liberty Zone (sec. 1400(f)) or an empowerment zone (sec. 1397A).

[11] Section 179(c)(2).

[12] Section 179(d)(1) requires that property be tangible to be eligible for expensing; in general, computer software is intangible property.

II. ELIMINATE THE DOUBLE TAXATION OF CORPORATE EARNINGS

Present Law

Under present law, a corporation pays a tax on its taxable income, generally at the rate of 35 percent.[13] To the extent that a corporation distributes its after-tax earnings and profits as a dividend to an individual shareholder, the recipient includes the amount of the dividend in gross income and pays tax at the shareholder's individual tax rate. The after-tax earnings and profits of a corporation consist of earnings that have been taxed to the corporation and earnings that have not been subject to tax due to exclusions, accelerated deductions and credits. A tax is imposed at capital gain rates on the gain of a shareholder at the time the shareholder sells his or her stock.

Under present law, corporations receiving dividends from domestic corporations generally are allowed a deduction of 70 percent or more of the amount of the dividends received. Certain anti-abuse rules prevent corporations from receiving low-taxed dividends and creating a capital loss.[14] The dividends-received deduction on certain debt-financed portfolio stock is reduced.[15]

Description of Proposal

In general

Under the proposal, the excludable portion of any dividend received by a shareholder is not included in gross income. The excludable portion of any dividend is the portion of the dividend which bears the same ratio to the dividend as the amount of the corporation's excludable dividend amount ("EDA") for a calendar year bears to all dividends paid by the corporation during the calendar year. The EDA, as discussed below, generally measures the corporation's fully taxed income reduced by taxes paid. In addition, shareholders may be allowed to increase the basis in their corporate stock to the extent the EDA exceeds the dividends paid by the corporation during the calendar year. These rules apply to both individual and corporate shareholders.[16]

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[13] Lower rates apply to the first $75,000 of taxable income. The benefits of the lower rates are phased-out.

[14] Secs. 246(c) and 1059.

[15] Sec. 246A.

[16] Certain taxable dividends received by a parent corporation from a subsidiary and taxable dividends received by a small business investment company will continue to receive a 100-percent dividends-received deduction.

Excludable dividend amount

A corporation calculates an EDA that measures the amount of the corporation's income that was fully taxed reduced by taxes paid. The EDA, for any calendar year, includes an amount the numerator of which is the amount of Federal income tax[17] in excess of all nonrefundable credits (other than the foreign tax credit and the minimum tax credit attributable to any minimum tax imposed in a taxable year ending before April 1, 2001) shown on a corporation's income tax return filed during the preceding calendar year ("applicable income tax") and the denominator of which is the highest corporate tax rate (35 percent under present law).[18] An assessment of tax not shown on a return is treated as if it were an amount of tax shown on a return for the calendar year in which the tax is assessed. If a tax is paid after the close of the year that it is shown on a return or otherwise assessed, the tax is taken into account in the year paid. The EDA is decreased by the amount of the Federal income tax taken into account in computing the increase in the EDA. No tax imposed for a taxable year ending before April 1, 2001, is treated as an applicable income tax.[19]

The EDA also includes the amount of dividends received from another corporation in the preceding calendar year that are excluded under this provision or amounts added to the basis of stock in the other corporation in the preceding calendar year (as described below).

To the extent that the EDA for a calendar year exceeds the maximum amount of dividends that can be paid by the corporation in the calendar year (determined by reference to the corporation's earnings and profits), the excess is added to the EDA for the succeeding year. No other carryover of an amount in the EDA is allowed except to the extent provided by regulations.

Retained earnings basis adjustments

If the amount of the EDA for a calendar year exceeds the amount of dividends paid by a corporation during that year, a shareholder is allowed to increase the shareholder's basis in the

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[17] For this purpose, the income tax includes the taxes imposed on a corporation by sections 11 (corporate income tax), 55 (alternative minimum tax), 511 (unrelated business income tax), 801 (life insurance company income tax), 831 (nonlife insurance company income tax), 882 (income tax on foreign corporations connected with U.S. business), 1201 (alternative capital gain tax), and 1291 (without regard to section 1291(c)(1)(B)) (tax on distributions from a passive foreign investment companies) and 1374 (tax on built-in gains of S corporations). It also includes the accumulated earnings tax and the personal holding company tax prior to their repeal by the proposal.

[18] For this purpose, a timely filed return is treated as filed in the calendar year which includes the date that is the 15th day of the 9th month following the close of the corporation's taxable year.

[19] A corporation whose taxable year ends April 30, 2001, and that files a timely income tax return and pays the tax is treated for purposes of computing an EDA as having filed the return on January 15, 2002 (the date that is the 15th day of the 9th month following the close of the taxable year).

corporation's stock by the portion (if any) of the excess allocated by the corporation to the stock. Basis increases are allocated by a corporation in the same manner as if the corporation actually had made dividend distributions, except that no amount may be allocated to stock described in section 1504(a)(4) (whether or not voting stock) that is limited and preferred as to dividends. The Secretary of the Treasury may prescribe regulations regarding allocations where a corporation has multiple classes of stock. Earnings and profits are adjusted in the same manner as if the allocation were a dividend (i.e., the distributing corporation's earnings and profits are reduced and, if the taxpayer receiving a basis adjustment is a corporation, that corporation's earnings and profits are increased). The allocated basis is added to the shares of stock the taxpayer holds and does not affect the holding periods of the shares.

Cumulative retained earnings basis adjustments account

Each corporation allocating basis adjustments is required to maintain a cumulative retained earnings basis adjustment account ("CREBAA"). The amount in the CREBAA is the cumulative amount of basis allocations for prior calendar years reduced by the amount of distributions in prior calendar years that were treated as described below.

To the extent of the amount in the CREBAA, distributions made by a corporation in a calendar year in excess of the amount in the EDA are not treated as dividends. Instead, the distributions reduce the basis of the shareholder's stock (or result in gain to the extent the distributions exceed the shareholder's basis).[20] These distributions reduce the amount in the CREBAA. The portion of any distribution to which this treatment applies is a fraction (not in excess of one) the numerator of which is the amount in the CREBAA account at the beginning of the calendar year and the denominator of which is the amount of all distributions (other than excluded dividends) paid by the corporation during the calendar year. This treatment is provided separately with respect to each class of stock for which a basis allocation was previously made.

For example, corporation X, a calendar year corporation, has a sole shareholder A. For its first taxable year, X has taxable income of $100, and files a return and pays a tax of $35 in its second taxable year. For all other taxable years in this example, X has no income or loss. On January 1 of its third taxable year, X has an EDA of $65 ($35/.35 less $35). X pays no dividends in the third year but allocates $65 of basis to A, and A increases its basis in the X stock by $65. X has a CREBAA of $65 at the beginning of the fourth year. The value of the X stock declines, and A sells the stock to B for $50 at the beginning of the fourth year. A's gain or loss is computed by taking the $65 into account in determining the basis in the X stock. X then distributes $65 to B later in the fourth year. B treats the $65 as a $50 reduction of the basis in the X stock to zero and a $15 capital gain from the sale of the X stock. X will have no balance in its CREBAA at the beginning of the fifth year.

[20] For purposes of this description, these distributions are referred to as distributions from a CREBAA.

Credits and refunds of overpayments of corporate tax

The overpayment of an applicable income tax (including an overpayment resulting by reason of a carryback) of a corporation is allowed as a credit or refund only to the extent of the applicable income taxes taken into account in computing the corporation's EDA for the calendar year following the calendar year in which the refund or credit is otherwise allowable plus, to the extent the corporation elects, an amount equal to the amount of tax that would produce the amount equal to the EDA for the calendar year in which the refund or credit is otherwise allowable. Thus, for example, assume a corporation has paid no tax in the current calendar year and has an EDA of $65 for the current calendar year. The refund of any overpayment in the year is limited to $35 (the amount of applicable income tax which results in an EDA of $65).

To the extent a credit or refund is made, for purposes of computing EDA, the tax for the calendar year for which the refund or credit is made is reduced (but not below zero) by the amount of the credit or refund, and the excess (if any) reduces the amount in the EDA for the current calendar year, using the formula which converts applicable income tax to an EDA. Thus, in the above example, the EDA for the current calendar year is reduced to zero.

Any overpayment not allowed as a credit or refund by reason of this limitation continues to be an overpayment that will be taken into account in succeeding calendar years, subject to this limitation, until a credit or refund is allowed or made. Interest on an overpayment is not allowed during the period the overpayment is not allowed as a credit or refund by reason of this limitation.

This limitation does not apply to the extent any overpayment is attributable to the foreign tax credit.

Foreign taxes and foreign persons

Treatment of foreign taxes

The foreign tax credit allowable to a domestic corporation does not reduce the amount of the applicable income tax of the corporation. Thus, to the extent the foreign tax credit is allowable, foreign taxes of a domestic corporation are treated as taxes paid for purposes of computing the EDA.

Treatment of distributions from foreign corporations

The EDA of a foreign corporation takes into account only the tax on taxable income effectively connected with the conduct of a U.S trade or business. The EDA is reduced by the amount of any branch profits tax imposed. Also, a foreign corporation's EDA is increased by (i) the excludable portion of any dividend received in excess of any U.S. withholding tax, and (ii) by the amount any distribution from a CREBAA in excess of any U.S. withholding tax.

No foreign tax credit is allowed with respect to the excludable portion of any dividend or from a distribution from a CREBAA.

Taxation of foreign shareholders

In the case of foreign shareholders, both individual and corporate, withholding taxes apply to all dividends and distributions from a CREBAA. Dividends are not treated as excludable and basis adjustments are not made with respect to stock held by foreign persons.

Regulated investment companies (RICs) and Real Estate Investment Trusts (REITs)

Except as provided in regulations, a regulated investment company ("RIC") or real estate investment trust ("REIT") does not have an EDA. Instead special rules allow the treatment of distributions received by, or basis adjustments allocated to, a RIC or REIT to pass through to its shareholders and holders of beneficial interests.

A RIC or REIT that receives excludable dividend income is allowed to designate dividends it makes to its shareholders as excludable dividends to the extent of the amount of excludable dividends it receives. In addition, a RIC or REIT may cause its shareholders to increase their bases in RIC or REIT stock to the extent of any basis increases allocated to stock held by the REIC or REIT. To the extent a RIC or REIT receives distributions from a CREBAA that reduce the basis of stock held by the RIC or REIT, distributions from the RIC or REIT may be treated as distributions from a CREBAA.

A RIC or REIT takes into account excludable dividends received, and distributions from a CREBAA that reduce the basis in stock it holds, in determining its distribution requirements. Excludable dividends and distributions from a CREBAA received by a RIC or REIT are taken into account in applying the gross income tests applicable to RICs and REITs.

If a shareholder or holder of a beneficial interest of a RIC or REIT receives an excludable dividend or is allocated a basis adjustment, any loss on the sale of the RIC or REIT stock held six months or less is disallowed to the extent of the amount of the exclusion or adjustment.

Insurance companies

Under the proposal, all excludable dividends received by a life insurance company are subject to proration. Thus, the excluded dividends are allocated on a pro rata basis between the insurance company's general earnings and those amounts required to pay benefits. The basis increase allocated to an insurance company is treated as an excludable dividend received in the year the adjustment is made, and, as such, is subject to proration. All excludable dividends and basis increases attributable to assets held in a separate account funding variable life insurance and annuity contracts are allocated to the separate account. The policyholder's share of excludable dividends and basis adjustments is includable in the company's income. The company's share of excludable dividends and basis adjustments is added to the shareholder's surplus account of a stock life insurance company.

Excludable dividends and retained earnings basis adjustments of a non-life insurance company are treated in the same manner as taxable dividends in computing the reduction of the deduction for losses.

Partnerships and S corporations

Excluded dividends and basis adjustments received by, or allocated to, partnerships and S corporations

Excludable dividends received by a partnership and basis adjustments to stock held by a partnership pass through to the partners. A partner's adjusted basis in his or her partnership interest is adjusted to reflect excludable dividends and basis adjustments to stock held by a partnership.

Rules similar to the partnership rules apply to S corporations and their shareholders. In the case of S corporations, these amounts also increase the accumulated adjustments account of the corporation.

Distributions made by S corporations

The general provisions, as modified as described below, relating to excludable dividends, retained earnings basis adjustments, and distributions from a CREBAA apply to S corporations and their shareholders. An S corporation takes into account, in computing its EDA, the applicable income taxes imposed for a taxable year the corporation was a C corporation[21], and the tax imposed on built-in gains under section 1374. No amounts are added to an EDA by reason of excludable dividends received by, or basis adjustments allocated to, an S corporation; instead these dividends and basis adjustments flow thru to the shareholders as described above.

The items taken into account in determining the tax imposed on built-in gains under section 1374 no longer will pass through to the shareholders, so that S corporation shareholders generally will not pay a tax on the items which are taxed at the corporate level.[22] The amount of these items (determined without regard to any net operating loss from a C corporation year[23] and reduced by the amount of the tax) increases the corporation's accumulated earnings and profits.

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[21] For example, the applicable income taxes imposed shown on a return filed in the final year the corporation was a C corporation or the first year the corporation is an S corporation are taken into account in computing the EDA for years the corporation is an S corporation. Any tax imposed by reason of the LIFO recapture rules of section 1363(d) will be taken into account in computing the corporation's EDA under the usual rules relating to the filing of returns and the payment of tax.

[22] The tax imposed by section 1374 will no longer pass through to shareholders as a loss sustained by the S corporation.

[23] A C corporation loss reduced the earnings and profits (or increased a deficit in earnings and profits) for the taxable year during which the loss arose.

Under regulations, distributions of excludable dividends and amounts from a CREBAA will be treated as made before distributions from the accumulated adjustments account. Thus, under the proposal, distributions by an S corporation with accumulated earnings and profits are made in the following order:

(1) An excludable dividend to the extent of the EDA.

(2) Reduction of basis (or recognition of gain) to the extent of the CREBAA.

(3) Reduction of basis (or recognition of gain) to the extent of the accumulated adjustments account.

(4) Taxable dividend to the extent of accumulated earnings and profits.

(5) Reduction of basis.

(6) Recognition of gain.

Treatment of passive investment income

The tax imposed on S corporation passive income is repealed. The provision terminating an S election as a result of passive income is also repealed.

Trusts and estates

The distributable net income of a trust or estate includes the excludable dividends received by the trust or estate and the distributions from a CREBAA received by the trust or estate.

Cooperatives

The EDA of a cooperative shall be allocated between shares of the corporation held by patrons and shares held by other persons as prescribed by regulations, and no deduction shall be allowed to the cooperative for any excludable dividend or distribution from a CREBAA paid to a patron.

Employee stock ownership plans (ESOPs)

Deductible dividends paid to an employee stock ownership plan ("ESOP") are not treated as dividends for purposes of applying the rules under dividend exclusion rules added by the proposal. Thus, for example, they are disregarded in determining the excludable portion of dividends paid with respect to all dividends made by the corporation. Also, stock on which a deductible dividend may be made is disregarded for purposes of allocating basis adjustments and making distributions from a CREBAA.

Private foundations

Excludable dividends and distributions from a CREBAA will not be included in the calculation of net investment income of a private foundation for purposes of the tax imposed by section 4940.

Anti-abuse rules

If a shareholder does not hold stock for more than 45 days during the 90-day period beginning 45 days before the ex-dividend date (as measured under section 246(c)),[24] the basis of the stock is reduced by the amount of any excludable dividends and allocated basis adjustments. Also, no deduction is allowable with respect to payments related to an excludable dividend or basis increase.

The rules of section 1059 requiring a basis reduction with respect to certain extraordinary dividends are made applicable to the excludable dividends received by, and basis adjustments allocated to, both corporate and noncorporate shareholders. Except as provided by regulations, if an excludable dividend is received, or a basis adjustment is allocated, with respect to a share of stock, the basis reduction applies to that share of stock, without regard to whether the excludable dividend or basis adjustment otherwise would be extraordinary, if received during the first year (or such other period provided by regulations) the taxpayer holds the stock.[25]

In the case of a corporate shareholder, the EDA and the earnings and profits are not increased by any amounts that result in a basis decrease under these rules.

Shareholder indebtedness

In the case of debt-financed portfolio stock held by a corporation, the excludable portion of a dividend is reduced by the average indebtedness percentage (as defined in section 246A) applicable to the stock. Also, there is included in gross income an amount equal to the basis adjustment to any stock held by the taxpayer multiplied by the average indebtedness percentage. The EDA of a corporate shareholder is not increased by any amount included in gross income by reason of this rule.

The investment interest limitations of section 163(d) for individuals apply. In addition, any excludable dividend is not investment income.

Redemptions

The present law rules relating to the treatment of redemptions of stock (either directly by a corporation or through the use of a related corporation) as a dividend or as an exchange remain

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[24] In the case of preferred stock, the periods are doubled.

[25] For this purpose, the holding period of stock acquired from a decedent is determined without regard to the rule otherwise providing for long-term capital gain treatment for the stock (sec. 1223(11)).

the same as under present law. Redemptions treated as exchanges reduce the EDA and CREBAA by the ratable share of the amount attributable to the shares redeemed.

Tax-free reorganizations and liquidations

In the case of a tax-free reorganization or liquidation, the current rules providing for the carryover of tax attributes are amended to provide for the carryover of the acquired corporation's EDA and CREBAA. In the case of a tax-free spin-off, the CREBAA is divided between the distributing and controlled corporations in accordance with regulations provided by the Secretary of the Treasury.

Rights to acquire stock

The Secretary of the Treasury may promulgate regulations treating the holder of a right to acquire stock as the holder of stock and regulations amending the option attribution rules.

Alternative minimum tax

Excluded dividends and reduced gain (or increased loss) resulting from the allocated basis adjustments are not an item of tax preference or adjustment for purposes of determining alternative minimum taxable income (including the determination of adjusted current earnings for corporations).

Accumulated earnings tax and personal holding company tax

The accumulated earnings tax and the personal holding company tax are repealed, for taxable years beginning after December 31, 2002, except that any deficiency dividend or dividend paid on or before the 15th day of the third month after the close of the taxable year which is taken into account in computing the tax for a taxable year beginning before that date may be made. Such a dividend is not treated as a dividend for purposes of applying the dividend exclusion rules of the proposal.

Compliance

Form 1099 will be revised to provide information to shareholders to indicate the amount of excludable dividends and the amount of basis adjustments and the date they are allocated.

A corporation will calculate the EDA and CREBAA and report those amounts to the IRS annually on its income tax return.

Regulations

The Secretary of the Treasury is provided authority to prescribe appropriate regulations to carry out these provisions.

The Secretary of the Treasury may amend the consolidated return regulations (effective as of the effective date of the proposal) to properly account for an EDA of a member of the group, for basis adjustments allocated to a member of the group, and for CREBAA distributions

received by a member of the group. These regulations may accelerate the inclusion in the excludable dividend amount with respect to activities of lower-tier members of the group, excludable dividends received from lower-tier members, and increases in basis allocated to stock in lower tier members.

Effective Date

In general

The proposal applies to distributions (and basis adjustments) made after December 31, 2002, with respect to taxes paid for taxable years ending on or after April 1, 2001. Thus, for example, a calendar year corporation that filed its 2001 federal income tax return and paid tax on September 15, 2002, may pay excluded dividends or allocate basis adjustments beginning January 1, 2003, based on the amount of tax paid with respect to its taxable income for 2001.

In 2003, one-third of the applicable income taxes will be taken into account in computing a corporation's EDA; in 2004, two-thirds of the applicable income taxes will be taken into account in computing a corporation's EDA; and in 2005 all of the applicable income taxes will be taken into account in computing a corporation's EDA. The provision will terminate after 2005.

Dividends-received deduction

The present law dividends received deduction continues to apply to distributions (not otherwise treated as excludable dividends) of earnings and profits accumulated in taxable years ending before April 1, 2001, that are distributed before January 1, 2006, with respect to stock issued before February 3, 2003.

Repeal of accumulated earnings tax, personal holding company tax and treatment of passive income of S corporations.

These provisions are repealed for taxable years beginning after December 31, 2004.

S corporation tax on built-in-gains

The provisions relating to the tax on the built-in gains of S corporations (section 1374) are effective for taxes imposed in taxable years beginning after December 31, 2002.[26]

[26] This effective date prevents a change in the taxation of S corporation shareholders for taxable years beginning before January 1, 2003.

DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO THE PROVISIONS OF THE "JOBS AND GROWTH TAX ACT OF 2003"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on May 8, 2003

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

May 8, 2003
JCX-44-03

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CONTENTS

INTRODUCTION

This document[1], prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's modification to the provisions of the "Jobs and Growth Tax Act of 2003." The Senate Committee on Finance has scheduled a markup of this proposal for May 8, 2003.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Modification to the Provisions of the "Jobs and Growth Tax Act of 2003."* (JCX-44-03), May 8, 2003.

I. MODIFICATIONS TO THE JOBS AND GROWTH ACT OF 2003

The following modifications are made to the provisions of the Jobs and Growth Act of 2003.

A. Alternative Minimum Tax Exemption Amounts

The proposal increases the AMT exemption amount for married taxpayers filing a joint return and surviving spouses to $61,000, and for unmarried taxpayers to $41,750, for taxable years beginning in 2003, 2004 and 2005.

B. Partial Exclusion of Dividend Income from Tax

Present Law

Under present law, dividends received by an individual are included in gross income and taxed as ordinary income at rates up to 38.6 percent.[2]

Description of Proposal

Under the proposal, an individual may exclude from gross income the first $500 ($250 in the case of a married individual filing a separate return) of dividends received from domestic corporations in a taxable year plus 10 percent (20 percent in the case of taxable years beginning after December 31, 2007) of the dividends received in excess of $500 (or $250).

If a shareholder does not hold a share of stock for more than 45 days during the 90-day period beginning 45 days before the ex-dividend date (as measured under section 246(c)),[3] dividends received on the stock are not eligible for the exclusion. Also, the exclusion is not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

If an individual receives an extraordinary dividend (within the meaning of section 1059(c)) eligible for the exclusion with respect to any share of stock, any loss on the sale of the stock is treated as a long-term capital loss to the extent of the amount of the dividend.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the exclusion.

The amount of dividends qualifying for the exclusion that may be paid by a regulated investment company or real estate investment trust, for any taxable year that the aggregate qualifying dividends received by the company or trust are less than 95 percent of its gross income (as specially computed), may not exceed the amount of such aggregate dividends received by the company or trust.

The exclusion does not apply to dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities.

In the case of a nonresident alien, the exclusion applies only for purposes of determining the taxes imposed pursuant to sections 871(b) and 877.

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[2] Another provision of the proposal reduces the maximum rate to 35 percent.

[3] In the case of preferred stock, the periods are doubled.

Dividends excluded under the proposal are included in modified adjusted gross income for purposes of the provisions of the Code determining the amount of any income inclusion, exclusion, deduction or credit based on the amount of that income. Also in determining eligibility for the earned income credit, any dividends excluded from gross income under this provision are included in disqualified income for purposes of the determining whether the individual has excessive investment income.

The tax rate for the accumulated earnings tax (sec. 531) and the personal holding company tax (sec. 541) is reduced to 90 percent (80 percent in the case of taxable years beginning after December 31, 2007) of the highest individual tax rate.

Amounts treated as ordinary income on the disposition of certain preferred stock (sec. 306) are treated as dividends for purposes of the proposal.

The collapsible corporation rules (sec. 341) are repealed.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2003, and beginning before January 1, 2013.

II. NEW PROVISIONS

A. Proposals Designed to Curtail Tax Shelters

1. Clarification of the economic substance doctrine

Present Law

In general

The Code provides specific rules regarding the computation of taxable income, including the amount, timing, source, and character of items of income, gain, loss and deduction. These rules are designed to provide for the computation of taxable income in a manner that provides for a degree of specificity to both taxpayers and the government. Taxpayers generally may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.

In addition to the statutory provisions, courts have developed several doctrines that can be applied to deny the tax benefits of tax motivated transactions, notwithstanding that the transaction may satisfy the literal requirements of a specific tax provision. The common-law doctrines are not entirely distinguishable, and their application to a given set of facts is often blurred by the courts and the IRS. Although these doctrines serve an important role in the administration of the tax system, invocation of these doctrines can be seen as at odds with an objective, "rule-based" system of taxation. Nonetheless, courts have applied the doctrines to deny tax benefits arising from certain transactions.[4]

A common-law doctrine applied with increasing frequency is the "economic substance" doctrine. In general, this doctrine denies tax benefits arising from transactions that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax.[5]

Economic substance doctrine

Courts generally deny claimed tax benefits if the transaction that gives rise to those benefits lacks economic substance independent of tax considerations -- notwithstanding that the purported activity actually occurred. The tax court has described the doctrine as follows:

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[4] *See, e.g., ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), *aff'g* 73 T.C.M. (CCH) 2189 (1997), *cert. denied* 526 U.S. 1017 (1999).

[5] Closely related doctrines also applied by the courts (sometimes interchangeable with the economic substance doctrine) include the "sham transaction doctrine" and the "business purpose doctrine". *See, e.g., Knetsch v. United States*, 364 U.S. 361 (1960) (denying interest deductions on a "sham transaction" whose only purpose was to create the deductions).

> The tax law . . . requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings.[6]

Business purpose doctrine

Another common law doctrine that overlays and is often considered together with (if not part and parcel of) the economic substance doctrine is the business purpose doctrine. The business purpose test is a subjective inquiry into the motives of the taxpayer -- that is, whether the taxpayer intended the transaction to serve some useful non-tax purpose. In making this determination, some courts have bifurcated a transaction in which independent activities with non-tax objectives have been combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.[7]

Application by the courts

Elements of the doctrine

There is a lack of uniformity regarding the proper application of the economic substance doctrine. Some courts apply a conjunctive test that requires a taxpayer to establish the presence of both economic substance (i.e., the objective component) and business purpose (i.e., the subjective component) in order for the transaction to sustain court scrutiny.[8] A narrower approach used by some courts is to invoke the economic substance doctrine only after a determination that the transaction lacks both a business purpose and economic substance (i.e., the existence of either a business purpose or economic substance would be sufficient to respect the transaction).[9] A third approach regards economic substance and business purpose as "simply

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[6] *ACM Partnership v. Commissioner*, 73 T.C.M. at 2215.

[7] *ACM Partnership v. Commissioner*, 157 F.3d at 256 n.48.

[8] *See, e.g., Pasternak v. Commissioner*, 990 F.2d 893, 898 (6th Cir. 1993) ("The threshold question is whether the transaction has economic substance. If the answer is yes, the question becomes whether the taxpayer was motivated by profit to participate in the transaction.")

[9] *See, e.g., Rice's Toyota World v. Commissioner*, 752 F.2d 89, 91-92 (4th Cir. 1985) ("To treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and, second, that the transaction has no economic substance because no reasonable possibility of a profit exists."); *IES Industries v. United States*, 253 F.3d 350, 358 (8th Cir. 2001) ("In determining whether a transaction is a sham for tax purposes [under the Eighth Circuit test], a transaction will be characterized as a sham if it is not motivated by any economic purpose out of tax considerations (the business purpose test), and if it is without economic substance because no real potential for profit exists" (the economic substance test).") As noted earlier, the economic substance doctrine and the sham transaction doctrine are similar and sometimes are applied interchangeably. For a

more precise factors to consider" in determining whether a transaction has any practical economic effects other than the creation of tax benefits.[10]

Profit potential

There also is a lack of uniformity regarding the necessity and level of profit potential necessary to establish economic substance. Since the time of *Gregory*, several courts have denied tax benefits on the grounds that the subject transactions lacked profit potential.[11] In addition, some courts have applied the economic substance doctrine to disallow tax benefits in transactions in which a taxpayer was exposed to risk and the transaction had a profit potential, but the court concluded that the economic risks and profit potential were insignificant when compared to the tax benefits.[12] Under this analysis, the taxpayer's profit potential must be more than nominal. Conversely, other courts view the application of the economic substance doctrine as requiring an objective determination of whether a "reasonable possibility of profit" from the transaction existed apart from the tax benefits.[13] In these cases, in assessing whether a

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more detailed discussion of the sham transaction doctrine, *see, e.g.*, Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (including Provisions Relating to Corporate Tax Shelters)* (JCS-3-99) at 182.

[10] *See, e.g., ACM Partnership v. Commissioner,* 157 F.3d at 247; *James v. Commissioner,* 899 F.2d 905, 908 (10th Cir. 1995); *Sacks v. Commissioner,* 69 F.3d 982, 985 (9th Cir. 1995) ("Instead, the consideration of business purpose and economic substance are simply more precise factors to consider . . ..We have repeatedly and carefully noted that this formulation cannot be used as a 'rigid two-step analysis'.").

[11] *See, e.g., Knetsch,* 364 U.S. at 361; *Goldstein v. Commissioner,* 364 F.2d 734 (2d Cir. 1966) (holding that an unprofitable, leveraged acquisition of Treasury bills, and accompanying prepaid interest deduction, lacked economic substance); *Ginsburg v. Commissioner,* 35 T.C.M. (CCH) 860 (1976) (holding that a leveraged cattle-breeding program lacked economic substance).

[12] *See, e.g., Goldstein v. Commissioner,* 364 F.2d at 739-40 (disallowing deduction even though taxpayer had a possibility of small gain or loss by owning Treasury bills); *Sheldon v. Commissioner,* 94 T.C. 738, 768 (1990) (stating, "potential for gain . . . is infinitesimally nominal and vastly insignificant when considered in comparison with the claimed deductions").

[13] *See, e.g., Rice's Toyota World v. Commissioner,* 752 F.2d at 94 (the economic substance inquiry requires an objective determination of whether a reasonable possibility of profit from the transaction existed apart from tax benefits); *Compaq Computer Corp. v. Commissioner,* 277 F.3d at 781 (applied the same test, *citing Rice's Toyota World*); *IES Industries v. United States,* 253 F.3d at 354 (the application of the objective economic substance test involves determining whether there was a "reasonable possibility of profit . . . apart from tax benefits.").

reasonable possibility of profit exists, it is sufficient if there is a nominal amount of pre-tax profit as measured against expected net tax benefits.

Description of Proposal

In general

The proposal clarifies and enhances the application of the economic substance doctrine. The proposal provides that a transaction has economic substance (and thus satisfies the economic substance doctrine) only if the taxpayer establishes that (1) the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and (2) the taxpayer has a substantial non-tax purpose for entering into such transaction and the transaction is a reasonable means of accomplishing such purpose.[14]

The proposal does not change current law standards used by courts in determining when to utilize an economic substance analysis. Also, the proposal does not alter the court's ability to aggregate or disaggregate a transaction when applying the doctrine. The proposal provides a uniform definition of economic substance, but does not alter court flexibility in other respects.

Conjunctive analysis

The proposal clarifies that the economic substance doctrine involves a conjunctive analysis -- there must be an objective inquiry regarding the effects of the transaction on the taxpayer's economic position, as well as a subjective inquiry regarding the taxpayer's motives for engaging in the transaction. Under the proposal, a transaction must satisfy both tests -- i.e., it must change in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and the taxpayer must have a substantial non-tax purpose for entering into such transaction (and the transaction is a reasonable means of accomplishing such purpose) -- in order to satisfy the economic substance doctrine. This clarification eliminates the disparity that exists among the circuits regarding the application of the doctrine, and modifies its application in those circuits in which either a change in economic position or a non-tax business purpose (without having both) is sufficient to satisfy the economic substance doctrine.

Non-tax business purpose

The proposal provides that a taxpayer's non-tax purpose for entering into a transaction (the second prong in the analysis) must be "substantial," and that the transaction must be "a reasonable means" of accomplishing such purpose. Under this formulation, the non-tax purpose

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[14] If the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine as defined in this proposal.

for the transaction must bear a reasonable relationship to the taxpayer's normal business operations or investment activities.[15]

In determining whether a taxpayer has a substantial non-tax business purpose, an objective of achieving a favorable accounting treatment for financial reporting purposes will not be treated as having a substantial non-tax purpose.[16] Furthermore, a transaction that is expected to increase financial accounting income as a result of generating tax deductions or losses without a corresponding financial accounting charge (i.e., a permanent book-tax difference)[17] should not be considered to have a substantial non-tax purpose unless a substantial non-tax purpose exists apart from the financial accounting benefits.[18]

By requiring that a transaction be a "reasonable means" of accomplishing its non-tax purpose, the proposal broadens the ability of the courts to bifurcate a transaction in which independent activities with non-tax objectives are combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.

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[15] *See,* Martin McMahon Jr., *Economic Substance, Purposive Activity, and Corporate Tax Shelters,* 94 Tax Notes 1017, 1023 (Feb. 25, 2002) (advocates "confining the most rigorous application of business purpose, economic substance, and purposive activity tests to transactions outside the ordinary course of the taxpayer's business -- those transactions that do not appear to contribute to any business activity or objective that the taxpayer may have had apart from tax planning but are merely loss generators."); Mark P. Gergen, *The Common Knowledge of Tax Abuse,* 54 SMU L. Rev. 131, 140 (Winter 2001) ("The message is that you can pick up tax gold if you find it in the street while going about your business, but you cannot go hunting for it.").

[16] However, if the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, such tax benefits should not be disallowed solely because the transaction results in a favorable accounting treatment. An example is the repealed foreign sales corporation rules.

[17] This includes tax deductions or losses that are anticipated to be recognized in a period subsequent to the period the financial accounting benefit is recognized. For example, FAS 109 in some cases permits the recognition of financial accounting benefits prior to the period in which the tax benefits are recognized for income tax purposes.

[18] Claiming that a financial accounting benefit constitutes a substantial non-tax purpose fails to consider the origin of the accounting benefit (i.e., reduction of taxes) and significantly diminishes the purpose for having a substantial non-tax purpose requirement. *See, e.g., American Electric Power, Inc. v. U.S.,* 136 F. Supp. 2d 762, 791-92 (S.D. Ohio, 2001) ("AEP's intended use of the cash flows generated by the [corporate-owned life insurance] plan is irrelevant to the subjective prong of the economic substance analysis. If a legitimate business purpose for the use of the tax savings 'were sufficient to breathe substance into a transaction whose only purpose was to reduce taxes, [then] every sham tax-shelter device might succeed,'" *citing Winn-Dixie v. Commissioner,* 113 T.C. 254, 287 (1999)).

Profit potential

Under the proposal, a taxpayer may rely on factors other than profit potential to demonstrate that a transaction results in a meaningful change in the taxpayer's economic position; the proposal merely sets forth a minimum threshold of profit potential if that test is relied on to demonstrate a meaningful change in economic position. If a taxpayer relies on a profit potential, however, the present value of the reasonably expected pre-tax profit must be substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.[19] Moreover, the profit potential must exceed a risk-free rate of return. In addition, in determining pre-tax profit, fees and other transaction expenses and foreign taxes are treated as expenses.

A lessor of tangible property subject to a qualified lease shall be considered to have satisfied the profit test with respect to the leased property. For this purpose, a 'qualified lease" is a lease that satisfies the factors for advance ruling purposes as provided by the Treasury Department.[20]In applying the profit test to the lessor of tangible property, certain deductions and other applicable tax credits (such as the rehabilitation tax credit and the low income housing tax credit) are not taken into account in measuring tax benefits. Thus, a traditional leveraged lease is not affected by the proposal to the extent it meets the present law standards.

Transactions with tax-indifferent parties

The proposal also provides special rules for transactions with tax-indifferent parties. For this purpose, a tax-indifferent party means any person or entity not subject to Federal income tax, or any person to whom an item would have no substantial impact on its income tax liability. Under these rules, the form of a financing transaction will not be respected if the present value of the tax deductions to be claimed is substantially in excess of the present value of the anticipated economic returns to the lender. Also, the form of a transaction with a tax-indifferent party will not be respected if it results in an allocation of income or gain to the tax-indifferent party in excess of the tax-indifferent party's economic gain or income or if the transaction results in the shifting of basis on account of overstating the income or gain of the tax-indifferent party.

Other rules

The Secretary may prescribe regulations which provide (1) exemptions from the application of this proposal, and (2) other rules as may be necessary or appropriate to carry out the purposes of the proposal.

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[19] Thus, a "reasonable possibility of profit" will not be sufficient to establish that a transaction has economic substance.

[20] See Rev. Proc. 2001-28, 2001-19 I.R.B. 1156 which provides guidelines that must be present for a lease to be eligible for advance ruling purposes. It is intended that a lease that satisfies Treasury Department guidelines for advance ruling purposes would be treated as a qualified lease.

No inference is intended as to the proper application of the economic substance doctrine under present law. In addition, except with respect to the economic substance doctrine, the proposal shall not be construed as altering or supplanting any other common law doctrine (including the sham transaction doctrine), and this proposal shall be construed as being additive to any such other doctrine.

Effective Date

The proposal applies to transactions entered into after the date of enactment.

2. Penalty for failure to disclose reportable transactions

Present Law

Regulations under section 6011 require a taxpayer to disclose with its tax return certain information with respect to each "reportable transaction" in which the taxpayer participates.[21]

There are six categories of reportable transactions. The first category is any transaction that is the same as (or substantially similar to)[22] a transaction that is specified by the Treasury Department as a tax avoidance transaction whose tax benefits are subject to disallowance under present law (referred to as a "listed transaction").[23]

The second category is any transaction that is offered under conditions of confidentiality. In general, if a taxpayer's disclosure of the structure or tax aspects of the transaction is limited in any way by an express or implied understanding or agreement with or for the benefit of any person who makes or provides a statement, oral or written, as to the potential tax consequences that may result from the transaction, it is considered offered under conditions of confidentiality (whether or not the understanding is legally binding).[24]

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[21] On February 27, 2003, the Treasury Department and the IRS released final regulations regarding the disclosure of reportable transactions. In general, the regulations are effective for transactions entered into on or after February 28, 2003.

The discussion of present law refers to the new regulations. The rules that apply with respect to transactions entered into on or before February 28, 2003, are contained in Treas. Reg. sec. 1.6011-4T in effect on the date the transaction was entered into.

[22] The regulations clarify that the term "substantially similar" includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Further, the term must be broadly construed in favor of disclosure. Treas. Reg. sec. 1-6011-4(c)(4).

[23] Treas. Reg. sec. 1.6011-4(b)(2).

[24] Treas. Reg. sec. 1.6011-4(b)(3).

The third category of reportable transactions is any transaction for which (1) the taxpayer has the right to a full or partial refund of fees if the intended tax consequences from the transaction are not sustained or, (2) the fees are contingent on the intended tax consequences from the transaction being sustained.[25]

The fourth category of reportable transactions relates to any transaction resulting in a taxpayer claiming a loss (under section 165) of at least (1) $10 million in any single year or $20 million in any combination of years by a corporate taxpayer or a partnership with only corporate partners; (2) $2 million in any single year or $4 million in any combination of years by all other partnerships, S corporations, trusts, and individuals; or (3) $50,000 in any single year for individuals or trusts if the loss arises with respect to foreign currency translation losses.[26]

The fifth category of reportable transactions refers to any transaction done by certain taxpayers[27] in which the tax treatment of the transaction differs (or is expected to differ) by more than $10 million from its treatment for book purposes (using generally accepted accounting principles) in any year.[28]

The final category of reportable transactions is any transaction that results in a tax credit exceeding $250,000 (including a foreign tax credit) if the taxpayer holds the underlying asset for less than 45 days.[29]

Under present law, there is no specific penalty for failing to disclose a reportable transaction; however, such a failure may jeopardize a taxpayer's ability to claim that any income tax understatement attributable to such undisclosed transaction is due to reasonable cause, and that the taxpayer acted in good faith.[30]

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[25] Treas. Reg. sec. 1.6011-4(b)(4).

[26] Treas. Reg. sec. 1.6011-4(b)(5). IRS Rev. Proc. 2003-24, 2003-11 I.R.B. 599, exempts certain types of losses from this reportable transaction category.

[27] The significant book-tax category applies only to taxpayers that are reporting companies under the Securities Exchange Act of 1934 or business entities that have $250 million or more in gross assets.

[28] Treas. Reg. sec. 1.6011-4(b)(6). IRS Rev. Proc. 2003-25, 2003-11 I.R.B. 601, exempts certain types of transactions from this reportable transaction category.

[29] Treas. Reg. sec. 1.6011-4(b)(7).

[30] Section 6664(c) provides that a taxpayer can avoid the imposition of a section 6662 accuracy-related penalty in cases where the taxpayer can demonstrate that there was reasonable cause for the underpayment and that the taxpayer acted in good faith. On December 31, 2002, the Treasury Department and IRS issued proposed regulations under sections 6662 and 6664 (REG-126016-01) that limit the defenses available to the imposition of an accuracy-related penalty in connection with a reportable transaction when the transaction is not disclosed.

Description of Proposal

In general

The proposal creates a new penalty for any person who fails to include with any return or statement any required information with respect to a reportable transaction. The new penalty applies without regard to whether the transaction ultimately results in an understatement of tax, and applies in addition to any accuracy-related penalty that may be imposed.

Transactions to be disclosed

The proposal does not define the terms "listed transaction"[31] or "reportable transaction," nor does the proposal explain the type of information that must be disclosed in order to avoid the imposition of a penalty. Rather, the proposal authorizes the Treasury Department to define a "listed transaction" and a "reportable transaction" under section 6011.

Penalty rate

The penalty for failing to disclose a reportable transaction is $50,000. The amount is increased to $100,000 if the failure is with respect to a listed transaction. For large entities and high net worth individuals, the penalty amount is doubled (i.e., $100,000 for a reportable transaction and $200,000 for a listed transaction). The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded (or abated) only if: (1) the taxpayer on whom the penalty is imposed has a history of complying with the Federal tax laws, (2) it is shown that the violation is due to an unintentional mistake of fact, (3) imposing the penalty would be against equity and good conscience, and (4) rescinding the penalty would promote compliance with the tax laws and effective tax administration. The authority to rescind the penalty can only be exercised by the IRS Commissioner personally or the head of the Office of Tax Shelter Analysis. Thus, the penalty cannot be rescinded by a revenue agent, an Appeals officer, or any other IRS personnel. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no taxpayer right to appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the disclosure penalties and providing a description of each penalty rescinded under this proposal and the reasons for the rescission.

A "large entity" is defined as any entity with gross receipts in excess of $10 million in the year of the transaction or in the preceding year. A "high net worth individual" is defined as any individual whose net worth exceeds $2 million, based on the fair market value of the individual's assets and liabilities immediately before entering into the transaction.

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[31] The proposal states that, except as provided in regulations, a listed transaction means a reportable transaction, which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011. For this purpose, it is expected that the definition of "substantially similar" will be the definition used in Treas. Reg. sec. 1.6011-4(c)(4). However, the Secretary may modify this definition (as well as the definitions of "listed transaction" and "reportable transactions") as appropriate.

A public entity that is required to pay a penalty for failing to disclose a listed transaction (or is subject to an understatement penalty attributable to a non-disclosed listed transaction, a non-disclosed reportable avoidance transaction,[32] or a transaction that lacks economic substance) must disclose the imposition of the penalty in reports to the Securities and Exchange Commission for such period as the Secretary shall specify. The proposal applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and treats any failure to disclose a transaction in such reports as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the Securities and Exchange Commission once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Effective Date

The proposal is effective for returns and statements the due date for which is after the date of enactment.

3. Modifications to the accuracy-related penalties for listed transactions and reportable transactions having a significant tax avoidance purpose

Present Law

The accuracy-related penalty applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of corporations), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[33] The amount of any understatement generally is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.[34]

Special rules apply with respect to tax shelters.[35] For understatements by non-corporate taxpayers attributable to tax shelters, the penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for the position, the taxpayer reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the penalty is unavailable to corporate tax shelters.

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[32] A reportable avoidance transaction is a reportable transaction with a significant tax avoidance purpose.

[33] Sec. 6662.

[34] Sec. 6662(d)(2)(B).

[35] Sec. 6662(d)(2)(C).

The understatement penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[36] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] . . . unambiguously concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[37]

Description of Proposal

In general

The proposal modifies the present-law accuracy related penalty by replacing the rules applicable to tax shelters with a new accuracy-related penalty that applies to listed transactions and reportable transactions with a significant tax avoidance purpose (hereinafter referred to as a "reportable avoidance transaction").[38] The penalty rate and defenses available to avoid the penalty vary depending on whether the transaction was adequately disclosed.

Disclosed transactions

In general, a 20-percent accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction. The only exception to the penalty is if the taxpayer satisfies a more stringent reasonable cause and good faith exception (hereinafter referred to as the "strengthened reasonable cause exception"), which is described below. The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

Undisclosed transactions

If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty applies), and the taxpayer is subject to an increased penalty rate equal to 30 percent of the understatement.

In addition, a public entity that is required to pay the 30 percent penalty must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A

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[36] Sec. 6664(c).

[37] Treas. Reg. sec. 1.6662-4(g)(4)(i)(B); Treas. Reg. sec. 1.6664-4(c).

[38] The terms "reportable transaction" and "listed transaction" have the same meanings as used for purposes of the penalty for failing to disclose reportable transactions.

taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Once the 30 percent penalty has been included in the Revenue Agent Report, the penalty cannot be compromised for purposes of a settlement without approval of the Commissioner personally or the head of the Office of Tax Shelter Analysis. Furthermore, the IRS is required to submit an annual report to Congress summarizing the application of this penalty and providing a description of each penalty compromised under this proposal and the reasons for the compromise.

Determination of the understatement amount

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this proposal, the amount of the understatement is determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return) [39], and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.

Strengthened reasonable cause exception

A penalty is not imposed under the proposal with respect to any portion of an understatement if it shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011,[40] (2) that there is or was substantial authority for such treatment, and (3) that the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed, and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised.

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[39] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income.

[40] *See* the previous discussion regarding the penalty for failing to disclose a reportable transaction.

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor," or (2) is a "disqualified opinion."

Disqualified tax advisor

A disqualified tax advisor is any advisor who (1) is a material advisor[41] and who participates in the organization, management, promotion or sale of the transaction or is related (within the meaning of section 267 or 707) to any person who so participates, (2) is compensated directly or indirectly[42] by a material advisor with respect to the transaction, (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained, or (4) as determined under regulations prescribed by the Secretary, has a continuing financial interest with respect to the transaction.

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents (1) establishing a structure used in connection with the transaction (such as a partnership agreement), (2) describing the transaction (such as an offering memorandum or other statement describing the transaction), or (3) relating to the registration of the transaction with any federal, state or local government body.[43] Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved

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[41] The term "material advisor" (defined below in connection with the new information filing requirements for material advisors) means any person who provides any material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons ($250,000 in any other case).

[42] This situation could arise, for example, when an advisor has an arrangement or understanding (oral or written) with an organizer, manager, or promoter of a reportable transaction that such party will recommend or refer potential participants to the advisor for an opinion regarding the tax treatment of the transaction.

[43] An advisor should not be treated as participating in the organization of a transaction if the advisor's only involvement with respect to the organization of the transaction is the rendering of an opinion regarding the tax consequences of such transaction. However, such an advisor may be a "disqualified tax advisor" with respect to the transaction if the advisor participates in the management, promotion or sale of the transaction (or if the advisor is compensated by a material advisor, has a fee arrangement that is contingent on the tax benefits of the transaction, or as determined by the Secretary, has a continuing financial interest with respect to the transaction).

in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

Disqualified opinion

An opinion may not be relied upon if the opinion (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events), (2) unreasonably relies upon representations, statements, finding or agreements of the taxpayer or any other person, (3) does not identify and consider all relevant facts, or (4) fails to meet any other requirement prescribed by the Secretary.

Coordination with other penalties

Any understatement upon which a penalty is imposed under this proposal is not subject to the accuracy-related penalty under section 6662. However, such understatement is included for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1).

The penalty imposed under this proposal shall not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

The proposal is effective for taxable years ending after the date of enactment.

4. Penalty for understatements from transactions lacking economic substance

Present Law

An accuracy-related penalty applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of corporations), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[44] The amount of any understatement is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.

Special rules apply with respect to tax shelters.[45] For understatements by non-corporate taxpayers attributable to tax shelters, the penalty may be avoided only if the taxpayer establishes

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[44] Sec. 6662.

[45] Sec. 6662(d)(2)(C).

that, in addition to having substantial authority for the position, the taxpayer reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the penalty is unavailable to corporate tax shelters.

The penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[46] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] . . . unambiguously concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[47]

Description of Proposal

The proposal imposes a penalty for an understatement attributable to any transaction that lacks economic substance (referred to in the statute as a "non-economic substance transaction understatement").[48] The penalty rate is 40 percent (reduced to 20 percent if the taxpayer adequately discloses the relevant facts in accordance with regulations prescribed under section 6011). No exceptions (including the reasonable cause or rescission rules) to the penalty would be available under the proposal (i.e., the penalty is a strict-liability penalty).

A "non-economic substance transaction" means any transaction if (1) the transaction lacks economic substance (as defined in the earlier proposal regarding the economic substance doctrine),[49] (2) the transaction was not respected under the rules relating to transactions with tax-indifferent parties (as described in the earlier proposal regarding the economic substance doctrine),[50] or (3) any similar rule of law. For this purpose, a similar rule of law would include, for example, an understatement attributable to a transaction that is determined to be a sham transaction.

For purposes of this proposal, the calculation of an "understatement" is made in the same manner as in the separate proposal relating to accuracy-related penalties for listed and reportable

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[46] Sec. 6664(c).

[47] Treas. Reg. sec. 1.6662-4(g)(4)(i)(B); Treas. Reg. sec. 1.6664-4(c).

[48] Thus, unlike the new accuracy-related penalty under section 6662A (which applies only to listed and reportable avoidance transactions), the new penalty under this proposal applies to any transaction that lacks economic substance.

[49] The proposal provides that a transaction has economic substance only if: (1) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (2) the transaction has a substantial non-tax purpose for entering into such transaction and is a reasonable means of accomplishing such purpose.

[50] The proposal provides that the form of a transaction that involves a tax-indifferent party will not be respected in certain circumstances.

avoidance transactions (new sec. 6662A). Thus, the amount of the understatement under this proposal would be determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return),[51] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item. In essence, the penalty will apply to the amount of any understatement attributable solely to a non-economic substance transaction.

Except as provided in regulations, the taxpayer's treatment of an item will not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.

A public entity that is required to pay a penalty under this proposal (regardless of whether the transaction was disclosed) must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Once a penalty (regardless of whether the transaction was disclosed) has been included in the Revenue Agent Report, the penalty cannot be compromised for purposes of a settlement without approval of the Commissioner personally or the head of the Office of Tax Shelter Analysis. Furthermore, the IRS is required to submit an annual report to Congress summarizing the application of this penalty and providing a description of each penalty compromised under this proposal and the reasons for the compromise.

Any understatement to which a penalty is imposed under this proposal will not be subject to the accuracy-related penalty under section 6662 or under new 6662A (accuracy-related penalties for listed and reportable avoidance transactions). However, an understatement under this proposal would be taken into account for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1). The penalty imposed under this proposal will not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

The proposal applies to transactions after the date of enactment.

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[51] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses that would (without regard to section 1211) be allowed for such year, would be treated as an increase in taxable income.

5. Modifications to the substantial understatement penalty

Present Law

Definition of substantial understatement

An accuracy-related penalty equal to 20 percent applies to any substantial understatement of tax. A "substantial understatement" exists if the correct income tax liability for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of most corporations).[52]

Reduction of understatement for certain positions

For purposes of determining whether a substantial understatement penalty applies, the amount of any understatement generally is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment.[53]

The Secretary is required to publish annually in the Federal Register a list of positions for which the Secretary believes there is not substantial authority and which affect a significant number of taxpayers.[54]

Description of Proposal

Definition of substantial understatement

The proposal modifies the definition of "substantial" for corporate taxpayers. Under the proposal, a corporate taxpayer has a substantial understatement if the amount of the understatement for the taxable year exceeds the lesser of (1) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, $10,000), or (2) $10 million.

Reduction of understatement for certain positions

The proposal elevates the standard that a taxpayer must satisfy in order to reduce the amount of an understatement for undisclosed items. With respect to the treatment of an item whose facts are not adequately disclosed, a resulting understatement is reduced only if the taxpayer had a reasonable belief that the tax treatment was more likely than not the proper treatment. The proposal also authorizes (but does not require) the Secretary to publish a list of positions for which it believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper treatment (without regard to whether

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[52] Sec. 6662(a) and (d)(1)(A).

[53] Sec. 6662(d)(2)(B).

[54] Sec. 6662(d)(2)(D).

such positions affect a significant number of taxpayers). The list shall be published in the Federal Register or the Internal Revenue Bulletin.

Effective Date

The proposal is effective for taxable years beginning after date of enactment.

6. Tax shelter exception to confidentiality privileges relating to taxpayer communications

Present Law

In general, a common law privilege of confidentiality exists for communications between an attorney and client with respect to the legal advice the attorney gives the client. The Code provides that, with respect to tax advice, the same common law protections of confidentiality that apply to a communication between a taxpayer and an attorney also apply to a communication between a taxpayer and a federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney. This rule is inapplicable to communications regarding corporate tax shelters.

Description of Proposal

The proposal modifies the rule relating to corporate tax shelters by making it applicable to all tax shelters, whether entered into by corporations, individuals, partnerships, tax-exempt entities, or any other entity. Accordingly, communications with respect to tax shelters are not subject to the confidentiality proposal of the Code that otherwise applies to a communication between a taxpayer and a federally authorized tax practitioner.

Effective Date

The proposal is effective with respect to communications made on or after the date of enactment.

7. Disclosure of reportable transactions by material advisors

Present Law

Registration of tax shelter arrangements

An organizer of a tax shelter is required to register the shelter with the Secretary not later than the day on which the shelter is first offered for sale.[55] A "tax shelter" means any investment with respect to which the tax shelter ratio[56] for any investor as of the close of any of the first five years ending after the investment is offered for sale may be greater than two to one and which is: (1) required to be registered under Federal or State securities laws, (2) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or State securities agency, or (3) a substantial investment (greater than $250,000 and at least five investors).[57]

Other promoted arrangements are treated as tax shelters for purposes of the registration requirement if: (1) a significant purpose of the arrangement is the avoidance or evasion of Federal income tax by a corporate participant; (2) the arrangement is offered under conditions of confidentiality; and (3) the promoter may receive fees in excess of $100,000 in the aggregate.[58]

In general, a transaction has a "significant purpose of avoiding or evading Federal income tax" if the transaction: (1) is the same as or substantially similar to a "listed transaction,"[59] or (2) is structured to produce tax benefits that constitute an important part of the intended results of the arrangement and the promoter reasonably expects to present the arrangement to more than one taxpayer.[60] Certain exceptions are provided with respect to the second category of transactions.[61]

An arrangement is offered under conditions of confidentiality if: (1) an offeree has an understanding or agreement to limit the disclosure of the transaction or any significant tax

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[55] Sec. 6111(a).

[56] The tax shelter ratio is, with respect to any year, the ratio that the aggregate amount of the deductions and 350 percent of the credits, which are represented to be potentially allowable to any investor, bears to the investment base (money plus basis of assets contributed) as of the close of the tax year.

[57] Sec. 6111(c).

[58] Sec. 6111(d).

[59] Treas. Reg. sec. 301.6111-2(b)(2).

[60] Treas. Reg. sec. 301.6111-2(b)(3).

[61] Treas. Reg. sec. 301.6111-2(b)(4).

features of the transaction; or (2) the promoter knows, or has reason to know that the offeree's use or disclosure of information relating to the transaction is limited in any other manner.[62]

Failure to register tax shelter

The penalty for failing to timely register a tax shelter (or for filing false or incomplete information with respect to the tax shelter registration) generally is the greater of one percent of the aggregate amount invested in the shelter or $500.[63] However, if the tax shelter involves an arrangement offered to a corporation under conditions of confidentiality, the penalty is the greater of $10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration. Intentional disregard of the requirement to register increases the penalty to 75 percent of the applicable fees.

Section 6707 also imposes (1) a $100 penalty on the promoter for each failure to furnish the investor with the required tax shelter identification number, and (2) a $250 penalty on the investor for each failure to include the tax shelter identification number on a return.

Description of Proposal

Disclosure of reportable transactions by material advisors

The proposal repeals the present law rules with respect to registration of tax shelters. Instead, the proposal requires each material advisor with respect to any reportable transaction (including any listed transaction)[64] to timely file an information return with the Secretary (in such form and manner as the Secretary may prescribe). The return must be filed on such date as specified by the Secretary.

The information return will include (1) information identifying and describing the transaction, (2) information describing any potential tax benefits expected to result from the transaction, and (3) such other information as the Secretary may prescribe. It is expected that the Secretary may seek from the material advisor the same type of information that the Secretary may request from a taxpayer in connection with a reportable transaction.[65]

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[62] The regulations provide that the determination of whether an arrangement is offered under conditions of confidentiality is based on all the facts and circumstances surrounding the offer. If an offeree's disclosure of the structure or tax aspects of the transaction are limited in any way by an express or implied understanding or agreement with or for the benefit of a tax shelter promoter, an offer is considered made under conditions of confidentiality, whether or not such understanding or agreement is legally binding. Treas. Reg. sec. 301.6111-2(c)(1).

[63] Sec. 6707.

[64] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related proposals.

[65] *See* the previous discussion regarding the disclosure requirements under new section 6707A.

A "material advisor" means any person (1) who provides material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, or carrying out any reportable transaction, and (2) who directly or indirectly derives gross income in excess of $250,000 ($50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons) for such advice or assistance.

The Secretary may prescribe regulations which provide (1) that only one material advisor has to file an information return in cases in which two or more material advisors would otherwise be required to file information returns with respect to a particular reportable transaction, (2) exemptions from the requirements of this section, and (3) other rules as may be necessary or appropriate to carry out the purposes of this section (including, for example, rules regarding the aggregation of fees in appropriate circumstances).

Penalty for failing to furnish information regarding reportable transactions

The proposal repeals the present law penalty for failure to register tax shelters. Instead, the proposal imposes a penalty on any material advisor who fails to file an information return, or who files a false or incomplete information return, with respect to a reportable transaction (including a listed transaction).[66] The amount of the penalty is $50,000. If the penalty is with respect to a listed transaction, the amount of the penalty is increased to the greater of (1) $200,000, or (2) 50 percent of the gross income of such person with respect to aid, assistance, or advice which is provided with respect to the transaction before the date the information return that includes the transaction is filed. Intentional disregard by a material advisor of the requirement to disclose a listed transaction increases the penalty to 75 percent of the gross income.

The penalty cannot be waived with respect to a listed transaction. As to reportable transactions, the penalty can be rescinded (or abated) only in exceptional circumstances.[67] All or part of the penalty may be rescinded only if: (1) the material advisor on whom the penalty is imposed has a history of complying with the Federal tax laws, (2) it is shown that the violation is due to an unintentional mistake of fact, (3) imposing the penalty would be against equity and good conscience, and (4) rescinding the penalty would promote compliance with the tax laws and effective tax administration. The authority to rescind the penalty can only be exercised by the Commissioner personally or the head of the Office of Tax Shelter Analysis; this authority to rescind cannot otherwise be delegated by the Commissioner. Thus, the penalty cannot be rescinded by a revenue agent, an Appeals officer, or other IRS personnel. The decision to rescind a penalty must be accompanied by a record describing the facts and reasons for the action and the amount rescinded. There will be no right to appeal a refusal to rescind a penalty. The IRS also is required to submit an annual report to Congress summarizing the application of the

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[66] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related proposals.

[67] The Secretary's present-law authority to postpone certain tax-related deadlines because of Presidentially-declared disasters (sec. 7508A) will also encompass the authority to postpone the reporting deadlines established by the proposal.

disclosure penalties and providing a description of each penalty rescinded under this proposal and the reasons for the rescission.

Effective Date

The proposal requiring disclosure of reportable transactions by material advisors applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment.

The proposal imposing a penalty for failing to disclose reportable transactions applies to returns the due date for which is after the date of enactment.

8. Investor lists and modification of penalty for failure to maintain investor lists

Present Law

Investor lists

Any organizer or seller of a potentially abusive tax shelter must maintain a list identifying each person who was sold an interest in any such tax shelter with respect to which registration was required under section 6111 (even though the particular party may not have been subject to confidentiality restrictions).[68] Recently issued regulations under section 6112 contain rules regarding the list maintenance requirements.[69] In general, the regulations apply to transactions that are potentially abusive tax shelters entered into, or acquired after, February 28, 2003.[70]

The regulations provide that a person is an organizer or seller of a potentially abusive tax shelter if the person is a material advisor with respect to that transaction.[71] A material advisor is defined any person who is required to register the transaction under section 6111, or expects to receive a minimum fee of (1) $250,000 for a transaction that is a potentially abusive tax shelter if all participants are corporations, or (2) $50,000 for any other transaction that is a potentially abusive tax shelter.[72] For listed transactions (as defined in the regulations under section 6011), the minimum fees are reduced to $25,000 and $10,000, respectively.

A potentially abusive tax shelter is any transaction that (1) is required to be registered under section 6111, (2) is a listed transaction (as defined under the regulations under section

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[68] Sec. 6112.

[69] Treas. Reg. sec. 301-6112-1.

[70] A special rule applies the list maintenance requirements to transactions entered into after February 28, 2000 if the transaction becomes a listed transaction (as defined in Treas. Reg. 1.6011-4) after February 28, 2003.

[71] Treas. Reg. sec. 301.6112-1(c)(1).

[72] Treas. Reg. sec. 301.6112-1(c)(2) and (3).

6011), or (3) any transaction that a potential material advisor, at the time the transaction is entered into, knows is or reasonably expects will become a reportable transaction (as defined under the new regulations under section 6011).[73]

The Secretary is required to prescribe regulations which provide that, in cases in which two or more persons are required to maintain the same list, only one person would be required to maintain the list.[74]

Penalty for failing to maintain investor lists

Under section 6708, the penalty for failing to maintain the list required under section 6112 is $50 for each name omitted from the list (with a maximum penalty of $100,000 per year).

Description of Proposal

Investor lists

Each material advisor[75] with respect to a reportable transaction (including a listed transaction)[76] is required to maintain a list that (1) identifies each person with respect to whom the advisor acted as a material advisor with respect to the reportable transaction, and (2) contains other information as may be required by the Secretary. In addition, the proposal authorizes (but does not require) the Secretary to prescribe regulations which provide that, in cases in which 2 or more persons are required to maintain the same list, only one person would be required to maintain the list.

Penalty for failing to maintain investor lists

The proposal modifies the penalty for failing to maintain the required list by making it a time-sensitive penalty. Thus, a material advisor who is required to maintain an investor list and who fails to make the list available upon written request by the Secretary within 20 business days after the request will be subject to a $10,000 per day penalty. The penalty applies to a person who fails to maintain a list, maintains an incomplete list, or has in fact maintained a list but does not make the list available to the Secretary. The penalty can be waived if the failure to make the list available is due to reasonable cause.[77]

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[73] Treas. Reg. sec. 301.6112-1(b).

[74] Sec. 6112(c)(2).

[75] The term "material advisor" has the same meaning as when used in connection with the requirement to file an information return under section 6111.

[76] The terms "reportable transaction" and "listed transaction" have the same meaning as previously described in connection with the taxpayer-related proposals.

[77] In no event will failure to maintain a list be considered reasonable cause for failing to make a list available to the Secretary.

Effective Date

The proposal requiring a material advisor to maintain an investor list applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment.

The proposal imposing a penalty for failing to maintain investor lists applies to requests made after the date of enactment.

9. Actions to enjoin conduct with respect to tax shelters and reportable transactions

Present Law

The Code authorizes civil action to enjoin any person from promoting abusive tax shelters or aiding or abetting the understatement of tax liability.[78]

Description of Proposal

The proposal expands this rule so that injunctions may also be sought with respect to the requirements relating to the reporting of reportable transactions[79] and the keeping of lists of investors by material advisors.[80] Thus, under the proposal, an injunction may be sought against a material advisor to enjoin the advisor from (1) failing to file an information return with respect to a reportable transaction, or (2) failing to maintain, or to timely furnish upon written request by the Secretary, a list of investors with respect to each reportable transaction.

Effective Date

The proposal is effective on the day after the date of enactment.

10. Understatement of taxpayer's liability by income tax return preparer

Present Law

An income tax return preparer who prepares a return with respect to which there is an understatement of tax that is due to a position for which there was not a realistic possibility of being sustained on its merits and the position was not disclosed (or was frivolous) is liable for a penalty of $250, provided that the preparer knew or reasonably should have known of the position. An income tax return preparer who prepares a return and engages in specified willful or reckless conduct with respect to preparing such a return is liable for a penalty of $1,000.

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[78] Sec. 7408.

[79] Sec. 6707, as amended by other proposals of this bill.

[80] Sec. 6708, as amended by other proposals of this bill.

Description of Proposal

The proposal alters the standards of conduct that must be met to avoid imposition of the first penalty. The proposal replaces the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position was more likely than not the proper treatment. The proposal also replaces the not frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

In addition, the proposal increases the amount of these penalties. The penalty relating to not having a reasonable belief that the tax treatment was more likely than not the proper tax treatment is increased from $250 to $1,000. The penalty relating to willful or reckless conduct is increased from $1,000 to $5,000.

Effective Date

The proposal is effective for documents prepared after the date of enactment.

11. Penalty for failure to report interests in foreign financial accounts

Present Law

The Secretary of the Treasury must require citizens, residents, or persons doing business in the United States to keep records and file reports when that person makes a transaction or maintains an account with a foreign financial entity.[81] In general, individuals must fulfill this requirement by answering questions regarding foreign accounts or foreign trusts that are contained in Part III of Schedule B of the IRS Form 1040. Taxpayers who answer "yes" in response to the question regarding foreign accounts must then file Treasury Department Form TD F 90-22.1. This form must be filed with the Department of the Treasury, and not as part of the tax return that is filed with the IRS.

The Secretary of the Treasury may impose a civil penalty on any person who willfully violates this reporting requirement. The civil penalty is the amount of the transaction or the value of the account, up to a maximum of $100,000; the minimum amount of the penalty is $25,000.[82] In addition, any person who willfully violates this reporting requirement is subject to a criminal penalty. The criminal penalty is a fine of not more than $250,000 or imprisonment for not more than five years (or both); if the violation is part of a pattern of illegal activity, the maximum amount of the fine is increased to $500,000 and the maximum length of imprisonment is increased to 10 years.[83]

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[81] 31 U.S.C. 5314.

[82] 31 U.S.C. 5321(a)(5).

[83] 31 U.S.C. 5322.

On April 26, 2002, the Secretary of the Treasury submitted to the Congress a report on these reporting requirements.[84] This report, which was statutorily required,[85] studies methods for improving compliance with these reporting requirements. It makes several administrative recommendations, but no legislative recommendations. A further report was required to be submitted by the Secretary of the Treasury to the Congress by October 26, 2002.

Description of Proposal

The proposal adds an additional civil penalty that may be imposed on any person who violates this reporting requirement (without regard to willfulness). This new civil penalty is up to $5,000. The penalty may be waived if any income from the account was properly reported on the income tax return and there was reasonable cause for the failure to report.

Effective Date

The proposal is effective with respect to failures to report occurring on or after the date of enactment.

12. Frivolous tax returns and submissions

Present Law

The Code provides that an individual who files a frivolous income tax return is subject to a penalty of $500 imposed by the IRS (sec. 6702). The Code also permits the Tax Court[86] to impose a penalty of up to $25,000 if a taxpayer has instituted or maintained proceedings primarily for delay or if the taxpayer's position in the proceeding is frivolous or groundless (sec. 6673(a)).

Description of Proposal

The proposal modifies the IRS-imposed penalty by increasing the amount of the penalty to up to $5,000 and by applying it to all taxpayers and to all types of Federal taxes.

The proposal also modifies present law with respect to certain submissions that raise frivolous arguments or that are intended to delay or impede tax administration. The submissions to which this proposal applies are requests for a collection due process hearing, installment agreements, offers-in-compromise, and taxpayer assistance orders. First, the proposal permits

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[84] *A Report to Congress in Accordance with Sec. 361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001,* April 26, 2002.

[85] Sec. 361(b) of the USA PATRIOT Act of 2001 (Pub. L. 107-56).

[86] Because in general the Tax Court is the only pre-payment forum available to taxpayers, it deals with most of the frivolous, groundless, or dilatory arguments raised in tax cases.

the IRS to dismiss such requests. Second, the proposal permits the IRS to impose a penalty of up to $5,000 for such requests, unless the taxpayer withdraws the request after being given an opportunity to do so.

The proposal requires the IRS to publish a list of positions, arguments, requests, and submissions determined to be frivolous for purposes of these proposals.

Effective Date

The proposal is effective for submissions made and issues raised after the date on which the Secretary first prescribes the required list.

13. Penalties on promoters of tax shelters

Present Law

A penalty is imposed on any person who organizes, assists in the organization of, or participates in the sale of any interest in, a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if in connection with such activity the person makes or furnishes a qualifying false or fraudulent statement or a gross valuation overstatement.[87] A qualified false or fraudulent statement is any statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter. A "gross valuation overstatement" means any statement as to the value of any property or services if the stated value exceeds 200 percent of the correct valuation, and the value is directly related to the amount of any allowable income tax deduction or credit.

The amount of the penalty is $1,000 (or, if the person establishes that it is less, 100 percent of the gross income derived or to be derived by the person from such activity). A penalty attributable to a gross valuation misstatement can be waived on a showing that there was a reasonable basis for the valuation and it was made in good faith.

Description of Proposal

The proposal modifies the penalty amount to equal 50 percent of the gross income derived by the person from the activity for which the penalty is imposed. The new penalty rate applies to any activity that involves a statement regarding the tax benefits of participating in a plan or arrangement if the person knows or has reason to know that such statement is false or fraudulent as to any material matter. The enhanced penalty does not apply to a gross valuation overstatement.

Effective Date

The proposal is effective for activities after the date of enactment.

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[87] Sec. 6700.

14. Extend statute of limitations for certain undisclosed transactions

Present Law

In general, the Code requires that taxes be assessed within three years[88] after the date a return is filed.[89] If there has been a substantial omission of items of gross income that total more than 25 percent of the amount of gross income shown on the return, the period during which an assessment must be made is extended to six years.[90] If an assessment is not made within the required time periods, the tax generally cannot be assessed or collected at any future time. Tax may be assessed at any time if the taxpayer files a false or fraudulent return with the intent to evade tax or if the taxpayer does not file a tax return at all.[91]

Description of Proposal

The proposal extends the statute of limitations to six years with respect to the entire tax return[92] if a taxpayer required to disclose a listed transaction[93] fails to do so in the manner required. For example, if a taxpayer entered into a transaction in 2005 that becomes a listed transaction in 2006 and the taxpayer fails to disclose such transaction in the manner required by Treasury regulations, the 2005 tax return will be subject to a six-year statute of limitations.[94]

Effective Date

The proposal is effective for transactions entered into in taxable years beginning after the date of enactment.

15. Deny deduction for interest paid to IRS on underpayments involving certain tax-motivated transactions

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[88] Sec. 6501(a).

[89] For this purpose, a return that is filed before the date on which it is due is considered to be filed on the required due date (sec. 6501(b)(1)).

[90] Sec. 6501(e).

[91] Sec. 6501(c).

[92] The tax year extended is the tax year the transaction is entered into.

[93] The term "listed transaction" has the same meaning as described in a previous proposal regarding the penalty for failure to disclose reportable transactions.

[94] However, if the Treasury Department lists a transaction in a year subsequent to the year a taxpayer entered into such transaction, and the taxpayer's tax return for the year the transaction was entered into is closed by the statute of limitations prior to the transaction becoming a listed transaction, this proposal does not re-open the statute of limitations for such year.

Present Law

In general, corporations may deduct interest paid or accrued within a taxable year on indebtedness.[95] Interest on indebtedness to the Federal government attributable to an underpayment of tax generally may be deducted pursuant to this provision.

Description of Proposal

The proposal disallows any deduction for interest paid or accrued within a taxable year on any portion of an underpayment of tax that is attributable to an understatement arising from (1) an undisclosed reportable avoidance transaction, (2) an undisclosed listed transaction, or (3) a transaction that lacks economic substance.[96]

Effective Date

The proposal is effective for underpayments attributable to transactions entered into in taxable years beginning after the date of enactment.

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[95] Sec. 163(a).

[96] The definitions of these transactions are the same as those previously described in connection with the proposal to modify the accuracy-related penalty for listed and certain reportable transactions and the proposal to impose a penalty on understatements attributable to transactions that lack economic substance.

B. Other Proposals

1. Affirmation of consolidated return regulation authority

Present Law

An affiliated group of corporations may elect to file a consolidated return in lieu of separate returns. A condition of electing to file a consolidated return is that all corporations that are members of the consolidated group must consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for filing such return.[97]

Section 1502 states:

> The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent the avoidance of such tax liability.[98]

Under this authority, the Treasury Department has issued extensive consolidated return regulations.[99]

In the recent case of *Rite Aid Corp. v. United States,*[100] the Federal Circuit Court of Appeals addressed the application of a particular provision of certain consolidated return loss

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[97] Sec. 1501.

[98] Sec. 1502.

[99] Regulations issued under the authority of section 1502 are considered to be "legislative" regulations rather than "interpretative" regulations, and as such are usually given greater deference by courts in case of a taxpayer challenge to such a regulation. *See*, S. Rep. No. 960, 70th Cong., 1st Sess. at 15, describing the consolidated return regulations as "legislative in character". The Supreme Court has stated that ". . . legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984) (involving an environmental protection regulation). For examples involving consolidated return regulations, *see, e.g., Wolter Construction Company v. Commissioner*, 634 F.2d 1029 (6th Cir. 1980); *Garvey, Inc. v. United States,* 1 Ct. Cl. 108 (1983), *aff'd* 726 F.2d 1569 (Fed. Cir. 1984), *cert. denied* 469 U.S. 823 (1984). *Compare, e.g., Audrey J. Walton v. Commissioner,* 115 T.C. 589 (2000), describing different standards of review. The case did not involve a consolidated return regulation.

[100] 255 F.3d 1357 (Fed. Cir. 2001), *reh'g denied,* 2001 U.S. App. LEXIS 23207 (Fed. Cir. Oct. 3, 2001).

disallowance regulations, and concluded that the provision was invalid.[101] The particular provision, known as the "duplicated loss" provision,[102] would have denied a loss on the sale of stock of a subsidiary by a parent corporation that had filed a consolidated return with the subsidiary, to the extent the subsidiary corporation had assets that had a built-in loss, or had a net operating loss, that could be recognized or used later.[103]

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[101] Prior to this decision, there had been a few instances involving prior laws in which certain consolidated return regulations were held to be invalid. *See, e.g., American Standard, Inc. v. United States,* 602 F.2d 256 (Ct. Cl. 1979), discussed in the text *infra. see also Union Carbide Corp. v. United States*, 612 F.2d 558 (Ct. Cl. 1979), and *Allied Corporation v. United States*, 685 F. 2d 396 (Ct. Cl. 1982), all three cases involving the allocation of income and loss within a consolidated group for purposes of computation of a deduction allowed under prior law by the Code for Western Hemisphere Trading Corporations. *See also Joseph Weidenhoff v. Commissioner*, 32 T.C. 1222, 1242-1244 (1959), involving the application of certain regulations to the excess profits tax credit allowed under prior law, and concluding that the Commissioner had applied a particular regulation in an arbitrary manner inconsistent with the wording of the regulation and inconsistent with even a consolidated group computation. *Cf. Kanawha Gas & Utilities Co. v. Commissioner*, 214 F.2d 685 (1954), concluding that the substance of a transaction was an acquisition of assets rather than stock. Thus, a regulation governing basis of the assets of consolidated subsidiaries did not apply to the case. *See also General Machinery Corporation v. Commissioner*, 33 B.T.A. 1215 (1936); *Lefcourt Realty Corporation*, 31 B.T.A. 978 (1935); *Helvering v. Morgans, Inc.*, 293 U.S. 121 (1934), interpreting the term "taxable year."

[102] Treas. Reg. Sec. 1.1502-20(c)(1)(iii).

[103] Treasury Regulation section 1.1502-20, generally imposing certain "loss disallowance" rules on the disposition of subsidiary stock, contained other limitations besides the "duplicated loss" rule that could limit the loss available to the group on a disposition of a subsidiary's stock. Treasury Regulation section 1.1502-20 as a whole was promulgated in connection with regulations issued under section 337(d), principally in connection with the so-called *General Utilities* repeal of 1986 (referring to the case of *General Utilities & Operating Company v. Helvering*, 296 U.S. 200 (1935)). Such repeal generally required a liquidating corporation, or a corporation acquired in a stock acquisition treated as a sale of assets, to pay corporate level tax on the excess of the value of its assets over the basis. Treasury regulation section 1.1502-20 principally reflected an attempt to prevent corporations filing consolidated returns from offsetting income with a loss on the sale of subsidiary stock. Such a loss could result from the unique upward adjustment of a subsidiary's stock basis required under the consolidated return regulations for subsidiary income earned in consolidation, an adjustment intended to prevent taxation of both the subsidiary and the parent on the same income or gain. As one example, absent a denial of certain losses on a sale of subsidiary stock, a consolidated group could obtain a loss deduction with respect to subsidiary stock, the basis of which originally reflected the subsidiary's value at the time of the purchase of the stock, and that had then been adjusted upward on recognition of any built-in income or gain of the subsidiary reflected in that value. The regulations also contained the duplicated loss factor addressed by the court in *Rite Aid*. The preamble to the regulations stated: "it is not administratively feasible to differentiate

The Federal Circuit Court opinion contained language discussing the fact that the regulation produced a result different than the result that would have obtained if the corporations had filed separate returns rather than consolidated returns.[104]

The Federal Circuit Court opinion cited a 1928 Senate Finance Committee Report to legislation that authorized consolidated return regulations, which stated that "many difficult and complicated problems, ... have arisen in the administration of the provisions permitting the filing of consolidated returns" and that the committee "found it necessary to delegate power to the commissioner to prescribe regulations legislative in character covering them."[105] The Court's opinion also cited a previous decision of the Court of Claims for the proposition, interpreting this legislative history, that section 1502 grants the Secretary "the power to conform the applicable income tax law of the Code to the special, myriad problems resulting from the filing of consolidated income tax returns;" but that section 1502 "does not authorize the Secretary to choose a method that imposes a tax on income that would not otherwise be taxed." [106]

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between loss attributable to built-in gain and duplicated loss." T.D. 8364, 1991-2 C.B. 43, 46 (Sept. 13, 1991). The government also argued in the *Rite Aid* case that duplicated loss was a separate concern of the regulations. 255 F.3d at 1360.

[104] For example, the court stated: "The duplicated loss factor . . . addresses a situation that arises from the sale of stock regardless of whether corporations file separate or consolidated returns. With I.R.C. secs. 382 and 383, Congress has addressed this situation by limiting the subsidiary's potential future deduction, not the parent's loss on the sale of stock under I.R.C. sec. 165." 255 F.3d 1357, 1360 (Fed. Cir. 2001).

[105] S. Rep. No. 960, 70th Cong., 1st Sess. 15 (1928). Though not quoted by the court in *Rite Aid*, the same Senate report also indicated that one purpose of the consolidated return authority was to permit treatment of the separate corporations as if they were a single unit, stating "The mere fact that by legal fiction several corporations owned by the same shareholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit." S. Rep. No. 960, 70th Cong., 1st Sess. 29 (1928).

[106] *American Standard, Inc. v. United States*, 602 F.2d 256, 261 (Ct. Cl. 1979). That case did not involve the question of separate returns as compared to a single return approach. It involved the computation of a Western Hemisphere Trade Corporation ("WHTC") deduction under prior law (which deduction would have been computed as a percentage of each WHTC's taxable income if the corporations had filed separate returns), in a case where a consolidated group included several WHTCs as well as other corporations. The question was how to apportion income and losses of the admittedly consolidated WHTCs and how to combine that computation with the rest of the group's consolidated income or losses. The court noted that the new, changed regulations approach varied from the approach taken to a similar problem involving public utilities within a group and previously allowed for WHTCs. The court objected that the allocation method adopted by the regulation allowed non-WHTC losses to reduce WHTC income. However, the court did not disallow a method that would net WHTC income of one WHTC with losses of another WHTC, a result that would not have occurred under separate

The Federal Circuit Court construed these authorities and applied them to invalidate Treas. Reg. Sec. 1.1502-20(c)(1)(iii), stating that:

> The loss realized on the sale of a former subsidiary's assets after the consolidated group sells the subsidiary's stock is not a problem resulting from the filing of consolidated income tax returns. The scenario also arises where a corporate shareholder sells the stock of a non-consolidated subsidiary. The corporate shareholder could realize a loss under I.R.C. sec. 1001, and deduct the loss under I.R.C. sec. 165. The subsidiary could then deduct any losses from a later sale of assets. The duplicated loss factor, therefore, addresses a situation that arises from the sale of stock regardless of whether corporations file separate or consolidated returns. With I.R.C. secs. 382 and 383, Congress has addressed this situation by limiting the subsidiary's potential future deduction, not the parent's loss on the sale of stock under I.R.C. sec. 165.[107]

The Treasury Department has announced that it will not continue to litigate the validity of the duplicated loss provision of the regulations, and has issued interim regulations that permit taxpayers for all years to elect a different treatment, though they may apply the provision for the past if they wish.[108]

Description of Proposal

The proposal confirms that, in exercising its authority under section 1502 to issue consolidated return regulations, the Treasury Department may provide rules treating corporations filing consolidated returns differently from corporations filing separate returns.

Thus, under the statutory authority of section 1502, the Treasury Department is authorized to issue consolidated return regulations utilizing either a single taxpayer or separate taxpayer approach or a combination of the two approaches, as Treasury deems necessary in order that the tax liability of any affiliated group of corporations making a consolidated return, and of each corporation in the group, both during and after the period of affiliation, may be determined and adjusted in such manner as clearly to reflect the income-tax liability and the various factors

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returns. Nor did the court expressly disallow a different fractional method that would net both income and losses of the WHTCs with those of other corporations in the consolidated group. The court also found that the regulation had been adopted without proper notice.

[107] *Rite Aid*, 255 F.3d at 1360.

[108] *See* Temp. Reg. 1.1502-20T(i)(2). The Treasury Department has also indicated its intention to continue to study all the issues that the original loss disallowance regulations addressed (including issues of furthering single entity principles) and possibly issue different regulations (not including the particular approach of Treas. Reg. Sec. 1.1502-20(c)(1)(iii)) on the issues in the future. *See* Notice 2002-11, 2002-7 I.R.B. 526 (Feb. 19, 2002); T.D. 8984, 67 F.R. 11034 (March 12, 2002); REG-102740-02, 67 F.R. 11070 (March 12, 2002); *see also* Notice 2002-18, 2002-12 I.R.B. 644 (March 25, 2002).

necessary for the determination of such liability, and in order to prevent avoidance of such liability.

Rite Aid is thus overruled to the extent it suggests that there is not a problem that can be addressed in consolidated return regulations if application of a particular Code provision on a separate taxpayer basis would produce a result different from single taxpayer principles that may be used for consolidation.

The proposal nevertheless allows the result of the *Rite Aid* case to stand with respect to the type of factual situation presented in the case. That is, the legislation provides for the override of the regulatory provision that took the approach of denying a loss on a deconsolidating disposition of stock of a consolidated subsidiary[109] to the extent the subsidiary had net operating losses or built in losses that could be used later outside the group.[110]

Retaining the result in the *Rite Aid* case with respect to the particular regulation section 1.1502-20(c)(1)(iii) as applied to the factual situation of the case does not in any way prevent or invalidate the various approaches Treasury has announced it will apply or that it intends to consider in lieu of the approach of that regulation, including, for example, the denial of a loss on a stock sale if inside losses of a subsidiary may also be used by the consolidated group, and the possible requirement that inside attributes be adjusted when a subsidiary leaves a group.[111]

Effective Date

The proposal is effective for all years, whether beginning before, on, or after the date of enactment of the proposal.

No inference is intended that the results following from this proposal are not the same as the results under present law.

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[109] Treas. Reg. Sec. 1.1502-20(c)(1)(iii).

[110] The proposal is not intended to overrule the current Treasury Department regulations, which allow taxpayers for the past to follow Treasury Regulations Section 1.1502-20(c)(1)(iii), if they choose to do so. Temp. Reg. Sec. 1.1502-20T(i)(2).

[111] *See, e.g.*, Notice 2002-11, 2002-7 I.R.B. 526 (Feb. 19, 2002); T.D. 8984, 67 F.R. 11034 (Mar.12, 2002); REG-102740-02, 67 F.R. 11070 (Mar.12, 2002); *see also* Notice 2002-18, 2002-12 I.R.B. 644 (Mar. 25, 2002). In exercising its authority under section 1502, the Secretary is also authorized to prescribe rules that protect the purpose of *General Utilities* repeal using presumptions and other simplifying conventions.

2. Chief Executive Officer Required To Sign Corporate Income Tax Returns

Present Law

The Code requires[112] that the income tax return of a corporation must be signed by either the president, the vice-president, the treasurer, the assistant treasurer, the chief accounting officer, or any other officer of the corporation authorized by the corporation to sign the return.

The Code also imposes[113] a criminal penalty on any person who willfully signs any tax return under penalties of perjury that that person does not believe to be true and correct with respect to every material matter at the time of filing. If convicted, the person is guilty of a felony; the Code imposes a fine of not more than $100,000[114] ($500,000 in the case of a corporation) or imprisonment of not more than three years, or both, together with the costs of prosecution.

Description of Proposal

The proposal requires that the chief executive officer of a corporation sign that corporation's income tax returns. If the corporation does not have a chief executive officer, the IRS may designate another officer of the corporation; otherwise, no other person is permitted to sign the income tax return of a corporation. It is intended that the IRS issue general guidance, such as a revenue procedure, to (1) address situations when a corporation does not have a chief executive officer, and (2) define who the chief executive officer is, in situations (for example) when the primary official bears a different title or when a corporation has multiple chief executive officers. It is intended that, in every instance, the highest ranking corporate officer (regardless of title) sign the tax return.

The proposal does not apply to the income tax returns of mutual funds;[115] they are required to be signed as under present law.

Effective Date

The proposal is effective for returns filed after the date of enactment.

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[112] Sec. 6062.

[113] Sec. 7206.

[114] Pursuant to 18 U.S.C. 3571, the maximum fine for an individual convicted of a felony is $250,000.

[115] The proposal does, however, apply to the income tax returns of mutual fund management companies and advisors.

C. Enron-Related Tax Shelter Related Provisions

1. Limitation on transfer and importation of built-in losses

Present Law

Generally, no gain or loss is recognized when one or more persons transfer property to a corporation in exchange for stock and immediately after the exchange such person or persons control the corporation.[116] The transferor's basis in the stock of the controlled corporation is the same as the basis of the property contributed to the controlled corporation, increased by the amount of any gain (or dividend) recognized by the transferor on the exchange, and reduced by the amount of any money or property received, and by the amount of any loss recognized by the transferor.[117]

The basis of property received by a corporation, whether from domestic or foreign transferors, in a tax-free incorporation, reorganization, or liquidation of a subsidiary corporation is the same as the adjusted basis in the hands of the transferor, adjusted for gain or loss recognized by the transferor.[118]

Description of Proposal

Importation of built-in losses

The proposal provides that if a net built-in loss is imported into the U.S in a tax-free organization or reorganization from persons not subject to U.S. tax, the basis of each property so transferred is its fair market value. A similar rule applies in the case of the tax-free liquidation by a domestic corporation of its foreign subsidiary.

Under the proposal, a net built-in loss is treated as imported into the U.S. if the aggregate adjusted bases of property received by a transferee corporation exceeds the fair market value of the properties transferred. Thus, for example, if in a tax-free incorporation, some properties are received by a corporation from U. S. persons subject to tax, and some properties are received from foreign persons not subject to U.S. tax, this provision applies to limit the adjusted basis of each property received from the foreign persons to the fair market value of the property. In the case of a transfer by a partnership (either domestic or foreign), this provision applies as if the properties had been transferred by each of the partners in proportion to their interests in the partnership.

Limitation on transfer of built-in-losses in section 351 transactions

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[116] Sec. 351.

[117] Sec. 358.

[118] Secs. 334(b) and 362(a) and (b).

The proposal provides that if the aggregate adjusted bases of property contributed by a transferor (or by a control group of which the transferor is a member) to a corporation exceed the aggregate fair market value of the property transferred in a tax-free incorporation, the transferee's aggregate basis of the properties is limited to the aggregate fair market value of the transferred property. Under the proposal, any required basis reduction is allocated among the transferred properties in proportion to after which the transferor owns at least 80 percent of the vote and value of the stock of the transferee corporation, any basis reduction required by the proposal is made to the stock received by the transferor and not to the assets transferred.

Effective Date

The proposal applies to transactions after February 13, 2003.

2. No reduction of basis under section 734 in stock held by partnership in corporate partner

Present Law

In general

Generally, a partner and the partnership do not recognize gain or loss on a contribution of property to a partnership.[119] Similarly, a partner and the partnership generally do not recognize gain or loss on the distribution of partnership property.[120] This includes current distributions and distributions in liquidation of a partner's interest.

Basis of property distributed in liquidation

The basis of property distributed in liquidation of a partner's interest is equal to the partner's tax basis in its partnership interest (reduced by any money distributed in the same transaction).[121] Thus, the partnership's tax basis in the distributed property is adjusted (increased or decreased) to reflect the partner's tax basis in the partnership interest.

Election to adjust basis of partnership property

When a partnership distributes partnership property, generally, the basis of partnership property is not adjusted to reflect the effects of the distribution or transfer. The partnership is permitted, however, to make an election (referred to as a 754 election) to adjust the basis of partnership property in the case of a distribution of partnership property.[122] The effect of the 754 election is that the partnership adjusts the basis of its remaining property to reflect any change in basis of the distributed property in the hands of the distributee partner resulting from the distribution transaction. Such a change could be a basis increase due to gain recognition, or a basis decrease due to the partner's adjusted basis in its partnership interest exceeding the adjusted basis of the property received. If the 754 election is made, it applies to the taxable year with respect to which such election was filed and all subsequent taxable years.

In the case of a distribution of partnership property to a partner with respect to which the 754 election is in effect, the partnership increases the basis of partnership property by (1) any gain recognized by the distributee partner (2) the excess of the adjusted basis of the distributed property to the partnership immediately before its distribution over the basis of the property to the distributee partner, and decreases the basis of partnership property by (1) any loss recognized by the distributee partner and (2) the excess of the basis of the property to the distributee partner

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[119] Sec. 721(a).

[120] Sec. 731(a) and (b).

[121] Sec. 732(b).

[122] Sec. 754.

over the adjusted basis of the distributed property to the partnership immediately before the distribution.

The allocation of the increase or decrease in basis of partnership property is made in a manner which has the effect of reducing the difference between the fair market value and the adjusted basis of partnership properties.[123] In addition, the allocation rules require that any increase or decrease in basis be allocated to partnership property of a like character to the property distributed. For this purpose, the two categories of assets are (1) capital assets and depreciable and real property used in the trade or business held for more than one year, and (2) any other property.[124]

Description of Proposal

The proposal provides that in applying the basis allocation rules to a distribution in liquidation of a partner's interest, a partnership is precluded from decreasing the basis of corporate stock of a partner or a related person. Any decrease in basis that, absent the proposal, would have been allocated to the stock is allocated to other partnership assets. If the decrease in basis exceeds the basis of the other partnership assets, then gain is recognized by the partnership in the amount of the excess.

Effective Date

The proposal applies to distributions after February 13, 2003.

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[123] Sec. 755(a).

[124] Sec. 755(b).

3. Repeal of special rules for FASITs

Present Law

Financial asset securitization investment trusts

In 1996, Congress created a new type of statutory entity called a "financial asset securitization trust" ("FASIT") that facilitates the securitization of debt obligations such as credit card receivables, home equity loans, and auto loans.[125] A FASIT generally is not taxable; the FASIT's taxable income or net loss flows through to the owner of the FASIT.

The ownership interest of a FASIT generally is required to be entirely held by a single domestic C corporation. In addition, a FASIT generally may hold only qualified debt obligations, and certain other specified assets, and is subject to certain restrictions on its activities. An entity that qualifies as a FASIT can issue one or more classes of instruments that meet certain specified requirements and treat those instruments as debt for Federal income tax purposes. Instruments issued by a FASIT bearing yields to maturity over five percentage points above the yield to maturity on specified United States government obligations (i.e., "high-yield interests") must be held, directly or indirectly, only by domestic C corporations that are not exempt from income tax.

Qualification as a FASIT

To qualify as a FASIT, an entity must: (1) make an election to be treated as a FASIT for the year of the election and all subsequent years;[126] (2) have assets substantially all of which (including assets that the FASIT is treated as owning because they support regular interests) are specified types called "permitted assets;" (3) have non-ownership interests be certain specified types of debt instruments called "regular interests"; (4) have a single ownership interest which is held by an "eligible holder"; and (5) not qualify as a regulated investment company ("RIC"). Any entity, including a corporation, partnership, or trust may be treated as a FASIT. In addition, a segregated pool of assets may qualify as a FASIT.

An entity ceases qualifying as a FASIT if the entity's owner ceases being an eligible corporation. Loss of FASIT status is treated as if all of the regular interests of the FASIT were retired and then reissued without the application of the rule that deems regular interests of a FASIT to be debt.

Permitted assets

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[125] Sections 860H through 860L.

[126] Once an election to be a FASIT is made, the election applies from the date specified in the election and all subsequent years until the entity ceases to be a FASIT. If an election to be a FASIT is made after the initial year of an entity, all of the assets in the entity at the time of the FASIT election are deemed contributed to the FASIT at that time and, accordingly, any gain (but not loss) on such assets will be recognized at that time.

For an entity or arrangement to qualify as a FASIT, substantially all of its assets must consist of the following "permitted assets": (1) cash and cash equivalents; (2) certain permitted debt instruments; (3) certain foreclosure property; (4) certain instruments or contracts that represent a hedge or guarantee of debt held or issued by the FASIT; (5) contract rights to acquire permitted debt instruments or hedges; and (6) a regular interest in another FASIT. Permitted assets may be acquired at any time by a FASIT, including any time after its formation.

"Regular interests" of a FASIT

"Regular interests" of a FASIT are treated as debt for Federal income tax purposes, regardless of whether instruments with similar terms issued by non-FASITs might be characterized as equity under general tax principles. To be treated as a "regular interest", an instrument must have fixed terms and must: (1) unconditionally entitle the holder to receive a specified principal amount; (2) pay interest that is based on (a) fixed rates, or (b) except as provided by regulations issued by the Treasury Secretary, variable rates permitted with respect to REMIC interests under section 860G(a)(1)(B)(i); (3) have a term to maturity of no more than 30 years, except as permitted by Treasury regulations; (4) be issued to the public with a premium of not more than 25 percent of its stated principal amount; and (5) have a yield to maturity determined on the date of issue of less than five percentage points above the applicable Federal rate ("AFR") for the calendar month in which the instrument is issued.

Permitted ownership holder

A permitted holder of the ownership interest in a FASIT generally is a non-exempt (i.e., taxable) domestic C corporation, other than a corporation that qualifies as a RIC, REIT, REMIC, or cooperative.

Transfers to FASITs

In general, gain (but not loss) is recognized immediately by the owner of the FASIT upon the transfer of assets to a FASIT. Where property is acquired by a FASIT from someone other than the FASIT's owner (or a person related to the FASIT's owner), the property is treated as being first acquired by the FASIT's owner for the FASIT's cost in acquiring the asset from the non-owner and then transferred by the owner to the FASIT.

Valuation rules. In general, except in the case of debt instruments, the value of FASIT assets is their fair market value. Similarly, in the case of debt instruments that are traded on an established securities market, the market price is used for purposes of determining the amount of gain realized upon contribution of such assets to a FASIT. However, in the case of debt instruments that are not traded on an established securities market, special valuation rules apply for purposes of computing gain on the transfer of such debt instruments to a FASIT. Under these rules, the value of such debt instruments is the sum of the present values of the reasonably expected cash flows from such obligations discounted over the weighted average life of such assets. The discount rate is 120 percent of the AFR, compounded semiannually, or such other rate that the Treasury Secretary shall prescribe by regulations.

Taxation of a FASIT

A FASIT generally is not subject to tax. Instead, all of the FASIT's assets and liabilities are treated as assets and liabilities of the FASIT's owner and any income, gain, deduction or loss of the FASIT is allocable directly to its owner. Accordingly, income tax rules applicable to a FASIT (e.g., related party rules, sec. 871(h), sec. 165(g)(2)) are to be applied in the same manner as they apply to the FASIT's owner. The taxable income of a FASIT is calculated using an accrual method of accounting. The constant yield method and principles that apply for purposes of determining original issue discount ("OID") accrual on debt obligations whose principal is subject to acceleration apply to all debt obligations held by a FASIT to calculate the FASIT's interest and discount income and premium deductions or adjustments.

Taxation of holders of FASIT regular interests

In general, a holder of a regular interest is taxed in the same manner as a holder of any other debt instrument, except that the regular interest holder is required to account for income relating to the interest on an accrual method of accounting, regardless of the method of accounting otherwise used by the holder.

Taxation of holders of FASIT ownership interests

Because all of the assets and liabilities of a FASIT are treated as assets and liabilities of the holder of a FASIT ownership interest, the ownership interest holder takes into account all of the FASIT's income, gain, deduction, or loss in computing its taxable income or net loss for the taxable year. The character of the income to the holder of an ownership interest is the same as its character to the FASIT, except tax-exempt interest is included in the income of the holder as ordinary income.

Although the recognition of losses on assets contributed to the FASIT is not allowed upon contribution of the assets, such losses may be allowed to the FASIT owner upon their disposition by the FASIT. Furthermore, the holder of a FASIT ownership interest is not permitted to offset taxable income from the FASIT ownership interest (including gain or loss from the sale of the ownership interest in the FASIT) with other losses of the holder. In addition, any net operating loss carryover of the FASIT owner shall be computed by disregarding any income arising by reason of a disallowed loss. Where the holder of a FASIT ownership interest is a member of a consolidated group, this rule applies to the consolidated group of corporations of which the holder is a member as if the group were a single taxpayer.

Description of Proposal

The proposal repeals the special rules for FASITs. The proposal provides a transition period for existing FASITs, pursuant to which the repeal of the FASIT rules would not apply to any FASIT in existence on the date of enactment to the extent that regular interests issued by the FASIT prior to such date continue to remain outstanding in accordance with their original terms.

Effective Date

Except as provided by the transition period for existing FASITs, the proposal is effective after February 13, 2003.

4. Expanded disallowance of deduction for interest on convertible debt

Present Law

Whether an instrument qualifies for tax purposes as debt or equity is determined under all the facts and circumstances based on principles developed in case law. If an instrument qualifies as equity, the issuer generally does not receive a deduction for dividends paid and the holder generally includes such dividends in income (although corporate holders generally may obtain a dividends-received deduction of at least 70 percent of the amount of the dividend). If an instrument qualifies as debt, the issuer may receive a deduction for accrued interest and the holder generally includes interest in income, subject to certain limitations.

Original issue discount ("OID") on a debt instrument is the excess of the stated redemption price at maturity over the issue price of the instrument. An issuer of a debt instrument with OID generally accrues and deducts the discount as interest over the life of the instrument even though interest may not be paid until the instrument matures. The holder of such a debt instrument also generally includes the OID in income on an accrual basis.

Under present law, no deduction is allowed for interest or OID on a debt instrument issued by a corporation (or issued by a partnership to the extent of its corporate partners) that is payable in equity of the issuer or a related party (within the meaning of sections 267(b) and 707(b)), including a debt instrument a substantial portion of which is mandatorily convertible or convertible at the issuer's option into equity of the issuer or a related party.[127] In addition, a debt instrument is treated as payable in equity if a substantial portion of the principal or interest is required to be determined, or may be determined at the option of the issuer or related party, by reference to the value of equity of the issuer or related party.[128] A debt instrument also is treated as payable in equity if it is part of an arrangement that is designed to result in the payment of the debt instrument with or by reference to such equity, such as in the case of certain issuances of a forward contract in connection with the issuance of debt, nonrecourse debt that is secured principally by such equity, or certain debt instruments that are paid in, converted to, or determined with reference to the value of equity if it may be so required at the option of the holder or a related party and there is a substantial certainty that option will be exercised.[129]

Description of Proposal

The proposal expands the present-law disallowance of interest deductions on certain corporate debt that is payable in, or by reference to the value of, equity. Under the proposal, the disallowance includes interest on corporate debt that is payable in, or by reference to the value of, any equity held by the issuer (or any related party) in any other person, without regard to

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[127] Sec. 163(l), enacted in the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, sec. 1005(a).

[128] Sec. 163(l)(3)(B).

[129] Sec. 163(l)(3)(C).

whether such equity represents more than a 50-percent ownership interest in such person. However, the proposal does not apply to debt that is issued by an active dealer in securities (or a related party) if the debt is payable in, or by reference to the value of, equity that is held by the securities dealer in its capacity as a dealer in securities.

Effective Date

This proposal applies to debt instruments that are issued after February 13, 2003.

5. Expanded authority to disallow tax benefits under section 269

Present Law

Section 269 provides that if a taxpayer acquires, directly or indirectly, control (defined as at least 50 percent of vote or value) of a corporation, and the principal purpose of the acquisition is the evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance that would not otherwise have been available, the Secretary may disallow the such tax benefits.[130] Similarly, if a corporation acquires, directly or indirectly, property of another corporation (not controlled, directly or indirectly, by the acquiring corporation or its stockholders immediately before the acquisition), the basis of such property is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose of the acquisition is the evasion or avoidance of Federal income tax by securing a tax benefit that would not otherwise have been available, the Secretary may disallow such tax benefits.[131]

Description of Proposal

The proposal expands section 269 by repealing (1) the requirement that the acquisition of stock be sufficient to obtain control of the corporation, and (2) the requirement that the acquisition of property be from a corporation not controlled by the acquirer. Thus, under the proposal, section 269 disallows the tax benefits of (1) any acquisition of stock in a corporation,[132] and (2) any acquisition by a corporation of property from a corporation in which the basis of such property is determined by reference to the basis in the hands of the transferor corporation, if the principal purpose of such acquisition is the of evasion or avoidance of Federal income tax.

Effective Date

The proposal applies to stock and property acquired after February 13, 2003.

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[130] Sec. 269(a)(1).

[131] Sec. 269(a)(2).

[132] In this regard, the proposal applies regardless of whether an acquisition results in an increase in the acquiror's ownership percentage in a corporation or involves the issuance of actual stock certificates or shares by a corporation to the acquiror.

6. Modification of CFC-PFIC coordination rules

Present Law

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F[133] and the passive foreign investment company rules.[134] A foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income, whether earned directly by the domestic corporation, repatriated as an actual dividend, or included under one of the anti-deferral regimes.[135]

Generally, income earned indirectly by a domestic corporation through a foreign corporation is subject to U.S. tax only when the income is distributed to the domestic corporation, because corporations generally are treated as separate taxable persons for Federal tax purposes. However, this deferral of U.S. tax is limited by anti-deferral regimes that impose current U.S. tax on certain types of income earned by certain corporations, in order to prevent taxpayers from avoiding U.S. tax by shifting passive or other highly mobile income into low-tax jurisdictions. Deferral of U.S. tax is considered appropriate, on the other hand, with respect to most types of active business income earned abroad.

Subpart F,[136] applicable to controlled foreign corporations and their shareholders, is the main anti-deferral regime of relevance to a U.S.-based multinational corporate group. A controlled foreign corporation generally is defined as any foreign corporation if U.S. persons own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value), taking into account only those U.S. persons that own at least 10 percent of the stock (measured by vote only).[137] Under the subpart F rules, the United States generally taxes the U.S. 10-percent shareholders of a controlled foreign corporation on their pro

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[133] Secs. 951-964.

[134] Secs. 1291-1298.

[135] Secs. 901, 902, 960, 1291(g).

[136] Secs. 951-964.

[137] Secs. 951(b), 957, 958.

rata shares of certain income of the controlled foreign corporation (referred to as "subpart F income"), without regard to whether the income is distributed to the shareholders.[138]

Subpart F income generally includes passive income and other income that is readily movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income,[139] insurance income,[140] and certain income relating to international boycotts and other violations of public policy.[141] Foreign base company income consists of foreign personal holding company income, which includes passive income (e.g., dividends, interest, rents, and royalties), as well as a number of categories of non-passive income, including foreign base company sales income, foreign base company services income, foreign base company shipping income and foreign base company oil-related income.[142]

In effect, the United States treats the U.S. 10-percent shareholders of a controlled foreign corporation as having received a current distribution out of the corporation's subpart F income. In addition, the U.S. 10-percent shareholders of a controlled foreign corporation are required to include currently in income for U.S. tax purposes their pro rata shares of the corporation's earnings invested in U.S. property.[143]

The Tax Reform Act of 1986 established an additional anti-deferral regime, for passive foreign investment companies. A passive foreign investment company generally is defined as any foreign corporation if 75 percent or more of its gross income for the taxable year consists of passive income, or 50 percent or more of its assets consists of assets that produce, or are held for the production of, passive income.[144] Alternative sets of income inclusion rules apply to U.S. persons that are shareholders in a passive foreign investment company, regardless of their percentage ownership in the company. One set of rules applies to passive foreign investment companies that are "qualified electing funds," under which electing U.S. shareholders currently include in gross income their respective shares of the company's earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received.[145] A second set of rules applies to passive foreign investment companies that are not qualified electing funds, under which U.S. shareholders pay tax on certain income or gain realized through the company, plus an interest charge that is attributable to the value of

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[138] Sec. 951(a).

[139] Sec. 954.

[140] Sec. 953.

[141] Sec. 952(a)(3)-(5).

[142] Sec. 954.

[143] Secs. 951(a)(1)(B), 956.

[144] Sec. 1297.

[145] Sec. 1293-1295.

deferral.[146] A third set of rules applies to passive foreign investment company stock that is marketable, under which electing U.S. shareholders currently take into account as income (or loss) the difference between the fair market value of the stock as of the close of the taxable year and their adjusted basis in such stock (subject to certain limitations), often referred to as "marking to market."[147]

Under section 1297(e), which was enacted in 1997 to address the overlap of the passive foreign investment company rules and subpart F, a controlled foreign corporation generally is not also treated as a passive foreign investment company with respect to a U.S. shareholder of the corporation. This exception applies regardless of the likelihood that the U.S. shareholder would actually be taxed under subpart F in the event that the controlled foreign corporation earns subpart F income. Thus, even in a case in which a controlled foreign corporation's subpart F income would be allocated to a different shareholder under the subpart F allocation rules, a U.S. shareholder would still qualify for the exception from the passive foreign investment company rules under section 1297(e).

Description of Proposal

The proposal adds an exception to section 1297(e) for U.S. shareholders that face only a remote likelihood of incurring a subpart F inclusion in the event that a controlled foreign corporation earns subpart F income, thus preserving the potential application of the passive foreign investment company rules in such cases.

Effective Date

The proposal is effective for taxable years of controlled foreign corporations beginning after February 13, 2003, and for taxable years of U.S. shareholders in which or with which such taxable years of controlled foreign corporations end.

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[146] Sec. 1291.

[147] Sec. 1296.

D. Impose Mark-to-Market Tax on Individuals Who Expatriate

Present Law

In general

U.S. citizens and residents generally are subject to U.S. income taxation on their worldwide income. The U.S. tax may be reduced or offset by a credit allowed for foreign income taxes paid with respect to foreign-source income. Nonresidents who are not U.S. citizens are taxed at a flat rate of 30 percent (or a lower treaty rate) on certain types of passive income derived from U.S. sources, and at regular graduated rates on net profits derived from a U.S. business.

Income tax rules with respect to expatriates

An individual who relinquishes his or her U.S. citizenship or terminates his or her U.S. residency with a principal purpose of avoiding U.S. taxes is subject to an alternative method of income taxation for the 10 taxable years ending after the expatriation or residency termination under section 877. The alternative method of taxation for expatriates modifies the rules generally applicable to the taxation of nonresident noncitizens in several ways. First, the individual is subject to tax on his or her U.S.-source income at the rates applicable to U.S. citizens rather than the rates applicable to other nonresident noncitizens. Unlike U.S. citizens, however, individuals subject to section 877 are not taxed on foreign-source income. Second, the scope of items treated as U.S.-source income for section 877 purposes is broader than those items generally considered to be U.S.-source income under the Code.[148] Third, individuals subject to section 877 are taxed on exchanges of certain types of property that give rise to U.S.-source income for property that gives rise to foreign-source income.[149] Fourth, an individual subject to section 877 who contributes property to a controlled foreign corporation is treated as receiving income or gain from such property directly and is taxable on such income or gain. The alternative method of taxation for expatriates

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[148] For example, gains on the sale or exchange of personal property located in the United States, and gains on the sale or exchange of stocks and securities issued by U.S. persons, generally are not considered to be U.S.-source income under the Code. Thus, such gains would not be taxable to a nonresident noncitizen. However, if an individual is subject to the alternative regime under sec. 877, such gains are treated as U.S.-source income with respect to that individual.

[149] For example, a former citizen who is subject to the alternative tax regime and who removes appreciated artwork that he or she owns from the United States could be subject to immediate U.S. tax on the appreciation. In this regard, the removal from the United States of appreciated tangible personal property having an aggregate fair market value in excess of $250,000 within the 15-year period beginning five years prior to the expatriation will be treated as an "exchange" subject to these rules.

applies only if it results in a higher U.S. tax liability than would otherwise be determined if the individual were taxed as a nonresident noncitizen.

The expatriation tax provisions apply to long-term residents of the United States whose U.S. residency is terminated. For this purpose, a long-term resident is any individual who was a lawful permanent resident of the United States for at least 8 out of the 15 taxable years ending with the year in which such termination occurs. In applying the 8-year test, an individual is not considered to be a lawful permanent resident for any year in which the individual is treated as a resident of another country under a treaty tie-breaker rule (and the individual does not elect to waive the benefits of such treaty).

Subject to the exceptions described below, an individual is treated as having expatriated or terminated residency with a principal purpose of avoiding U.S. taxes if either: (1) the individual's average annual U.S. Federal income tax liability for the 5 taxable years ending before the date of the individual's loss of U.S. citizenship or termination of U.S. residency is greater than $100,000 (the "tax liability test"), or (2) the individual's net worth as of the date of such loss or termination is $500,000 or more (the "net worth test"). The dollar amount thresholds contained in the tax liability test and the net worth test are indexed for inflation in the case of a loss of citizenship or termination of residency occurring in any calendar year after 1996. An individual who falls below these thresholds is not automatically treated as having a principal purpose of tax avoidance, but nevertheless is subject to the expatriation tax provisions if the individual's loss of citizenship or termination of residency in fact did have as one of its principal purposes the avoidance of tax.

Certain exceptions from the treatment that an individual relinquished his or her U.S. citizenship or terminated his or her U.S. residency for tax avoidance purposes may also apply. For example, a U.S. citizen who loses his or her citizenship and who satisfies either the tax liability test or the net worth test (described above) can avoid being deemed to have a principal purpose of tax avoidance if the individual falls within certain categories (such as being a dual citizen) and the individual, within one year from the date of loss of citizenship, submits a ruling request for a determination by the Secretary of the Treasury as to whether such loss had as one of its principal purposes the avoidance of taxes.

Estate tax rules with respect to expatriates

Nonresident noncitizens generally are subject to estate tax on certain transfers of U.S.-situated property at death.[150] Such property includes real estate and tangible property located within the United States. Moreover, for estate tax purposes, stock held by nonresident noncitizens is treated as U.S.-situated if issued by a U.S. corporation.

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[150] The Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act") repealed the estate tax for estates of decedents dying after December 31, 2009. However, the Act included a "sunset" provision, pursuant to which the Act's provisions (including estate tax repeal) do not apply to estates of decedents dying after December 31, 2010.

Special rules apply to U.S. citizens who relinquish their citizenship and long-term residents who terminate their U.S. residency within the 10 years prior to the date of death, unless the loss of status did not have as one its principal purposes the avoidance of tax (sec. 2107). Under these rules, the decedent's estate includes the proportion of the decedent's stock in a foreign corporation that the fair market value of the U.S.-situs assets owned by the corporation bears to the total assets of the corporation. This rule applies only if (1) the decedent owned, directly, at death 10 percent or more of the combined voting power of all voting stock of the corporation and (2) the decedent owned, directly or indirectly, at death more than 50 percent of the total voting stock of the corporation or more than 50 percent of the total value of all stock of the corporation.

Taxpayers are deemed to have a principal purpose of tax avoidance if they meet the five-year tax liability test or the net worth test, discussed above. Exceptions from this tax avoidance treatment apply in the same circumstances as those described above (relating to certain dual citizens and other individuals who submit a timely and complete ruling request with the IRS as to whether their expatriation or residency termination had a principal purpose of tax avoidance).

Gift tax rules with respect to expatriates

Nonresident noncitizens generally are subject to gift tax on certain transfers by gift of U.S.-situated property. Such property includes real estate and tangible property located within the United States. Unlike the estate tax rules for U.S. stock held by nonresidents, however, nonresident noncitizens generally are not subject to U.S. gift tax on the transfer of intangibles, such as stock or securities, regardless of where such property is situated.

Special rules apply to U.S. citizens who relinquish their U.S. citizenship or long-term residents of the United States who terminate their U.S. residency within the 10 years prior to the date of transfer, unless such loss did not have as one of its principal purposes the avoidance of tax (sec. 2501(a)(3)). Under these rules, nonresident noncitizens are subject to gift tax on transfers of intangibles, such as stock or securities. Taxpayers are deemed to have a principal purpose of tax avoidance if they meet the five-year tax liability test or the net worth test, discussed above. Exceptions from this tax avoidance treatment apply in the same circumstances as those described above (relating to certain dual citizens and other individuals who submit a timely and complete ruling request with the IRS as to whether their expatriation or residency termination had a principal purpose of tax avoidance).

Other tax rules with respect to expatriates

The expatriation tax provisions permit a credit against the U.S. tax imposed under such provisions for any foreign income, gift, estate, or similar taxes paid with respect to the items subject to such taxation. This credit is available only against the tax imposed solely as a result of the expatriation tax provisions, and is not available to be used to offset any other U.S. tax liability.

In addition, certain information reporting requirements apply. Under these rules, a U.S. citizen who loses his or her citizenship is required to provide a statement to the State Department (or other designated government entity) that includes the individual's social security number, forwarding foreign address, new country of residence and citizenship, a balance sheet in the case of individuals with a net worth of at least $500,000, and such other information as the Secretary may prescribe. The information statement must be provided no later than the earliest day on which the individual (1) renounces the individual's U.S. nationality before a diplomatic or consular officer of the United States, (2) furnishes to the U.S. Department of State a statement of voluntary relinquishment of U.S. nationality confirming an act of expatriation, (3) is issued a certificate of loss of U.S. nationality by the U.S. Department of State, or (4) loses U.S. nationality because the individual's certificate of naturalization is canceled by a U.S. court. The entity to which such statement is to be provided is required to provide to the Secretary of the Treasury copies of all statements received and the names of individuals who refuse to provide such statements. A long-term resident whose U.S. residency is terminated is required to attach a similar statement to his or her U.S. income tax return for the year of such termination. An individual's failure to provide the required statement results in the imposition of a penalty for each year the failure continues equal to the greater of (1) 5 percent of the individual's expatriation tax liability for such year, or (2) $1,000.

The State Department is required to provide the Secretary of the Treasury with a copy of each certificate of loss of nationality approved by the State Department. Similarly, the agency administering the immigration laws is required to provide the Secretary of the Treasury with the name of each individual whose status as a lawful permanent resident has been revoked or has been determined to have been abandoned. Further, the Secretary of the Treasury is required to publish in the Federal Register the names of all former U.S. citizens with respect to whom it receives the required statements or whose names or certificates of loss of nationality it receives under the foregoing information-sharing provisions.

Immigration rules with respect to expatriates

Under U.S. immigration laws, any former U.S. citizen who officially renounces his or her U.S. citizenship and who is determined by the Attorney General to have renounced for the purpose of U.S. tax avoidance is ineligible to receive a U.S. visa and will be denied entry into the United States. This provision was included as an amendment (the "Reed amendment") to immigration legislation that was enacted in 1996.

Description of Proposal

In general

The proposal generally subjects certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who terminate their U.S. residence to tax on the net unrealized gain in their property as if such property were sold for fair market value on the day before the expatriation or residency termination. Gain from the deemed

sale is taken into account at that time without regard to other Code provisions; any loss from the deemed sale generally would be taken into account to the extent otherwise provided in the Code. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom relinquish citizenship or terminate residency). The $600,000 amount is increased by a cost of living adjustment factor for calendar years after 2002.

Individuals covered

Under the proposal, the mark-to-market tax applies to U.S. citizens who relinquish citizenship and long-term residents who terminate U.S. residency. An individual is a long-term resident if he or she was a lawful permanent resident for at least eight out of the 15 taxable years ending with the year in which the termination of residency occurs. An individual is considered to terminate long-term residency when either the individual ceases to be a lawful permanent resident (i.e., loses his or her green card status), or the individual is treated as a resident of another country under a tax treaty and the individual does not waive the benefits of the treaty.

Exceptions from the mark-to-market tax are provided in two situations. The first exception applies to an individual who was born with citizenship both in the United States and in another country; provided that (1) as of the expatriation date the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual was not a resident of the United States for the five taxable years ending with the year of expatriation. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18 and a half, provided that the individual was a resident of the United States for no more than five taxable years before such relinquishment.

Election to be treated as a U.S. citizen

Under the proposal, an individual is permitted to make an irrevocable election to continue to be taxed as a U.S. citizen with respect to all property that otherwise is covered by the expatriation tax. This election is an "all or nothing" election; an individual is not permitted to elect this treatment for some property but not for other property. The election, if made, would apply to all property that would be subject to the expatriation tax and to any property the basis of which is determined by reference to such property. Under this election, the individual would continue to pay U.S. income taxes at the rates applicable to U.S. citizens following expatriation on any income generated by the property and on any gain realized on the disposition of the property. In addition, the property would continue to be subject to U.S. gift, estate, and generation-skipping transfer taxes. In order to make this election, the taxpayer would be required to waive any treaty rights that would preclude the collection of the tax.

The individual also would be required to provide security to ensure payment of the tax under this election in such form, manner, and amount as the Secretary of the Treasury requires. The amount of mark-to-market tax that would have been owed but for this election (including any interest, penalties, and certain other items) shall be a lien in

favor of the United States on all U.S.-situs property owned by the individual. This lien shall arise on the expatriation date and shall continue until the tax liability is satisfied, the tax liability has become unenforceable by reason of lapse of time, or the Secretary is satisfied that no further tax liability may arise by reason of this proposal. The rules of section 6324A(d)(1), (3), and (4) (relating to liens arising in connection with the deferral of estate tax under section 6166) apply to liens arising under this proposal.

Date of relinquishment of citizenship

Under the proposal, an individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates: (1) the date that the individual renounces U.S. nationality before a diplomatic or consular officer of the United States (provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (2) the date that the individual furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act (again, provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (3) the date that the State Department issues a certificate of loss of nationality; or (4) the date that a U.S. court cancels a naturalized citizen's certificate of naturalization.

Deemed sale of property upon expatriation or residency termination

The deemed sale rule of the proposal generally applies to all property interests held by the individual on the date of relinquishment of citizenship or termination of residency. Special rules apply in the case of trust interests, as described below. U.S. real property interests, which remain subject to U.S. tax in the hands of nonresident noncitizens, generally are excepted from the proposal. Regulatory authority is granted to the Treasury to except other types of property from the proposal.

Under the proposal, an individual who is subject to the mark-to-market tax is required to pay a tentative tax equal to the amount of tax that would be due for a hypothetical short tax year ending on the date the individual relinquished citizenship or terminated residency. Thus, the tentative tax is based on all income, gain, deductions, loss, and credits of the individual for the year through such date, including amounts realized from the deemed sale of property. The tentative tax is due on the 90th day after the date of relinquishment of citizenship or termination of residency.

Retirement plans and similar arrangements

Subject to certain exceptions, the proposal applies to all property interests held by the individual at the time of relinquishment of citizenship or termination of residency. Accordingly, such property includes an interest in an employer-sponsored retirement plan or deferred compensation arrangement as well as an interest in an individual retirement

account or annuity (i.e., an IRA).[151] However, the proposal contains a special rule for an interest in a "qualified retirement plan." For purposes of the proposal, a "qualified retirement plan" includes an employer-sponsored qualified plan (sec. 401(a)), a qualified annuity (sec. 403(a)), a tax-sheltered annuity (sec. 403(b)), an eligible deferred compensation plan of a governmental employer (sec. 457(b)), or an IRA (sec. 408). The special retirement plan rule applies also, to the extent provided in regulations, to any foreign plan or similar retirement arrangement or program. An interest in a trust that is part of a qualified retirement plan or other arrangement that is subject to the special retirement plan rule is not subject to the rules for interests in trusts (discussed below).

Under the special rule, an amount equal to the present value of the individual's vested, accrued benefit under a qualified retirement plan is treated as having been received by the individual as a distribution under the plan on the day before the individual's relinquishment of citizenship or termination of residency. It is not intended that the plan would be deemed to have made a distribution for purposes of the tax-favored status of the plan, such as whether a plan may permit distributions before a participant has severed employment. In the case of any later distribution to the individual from the plan, the amount otherwise includible in the individual's income as a result of the distribution is reduced to reflect the amount previously included in income under the special retirement plan rule. The amount of the reduction applied to a distribution is the excess of: (1) the amount included in income under the special retirement plan rule over (2) the total reductions applied to any prior distributions. However, under the proposal, the retirement plan, and any person acting on the plan's behalf, will treat any later distribution in the same manner as the distribution would be treated without regard to the special retirement plan rule.

It is expected that the Treasury Department will provide guidance for determining the present value of an individual's vested, accrued benefit under a qualified retirement plan, such as the individual's account balance in the case of a defined contribution plan or an IRA, or present value determined under the qualified joint and survivor annuity rules applicable to a defined benefit plan (sec. 417(e)).

Deferral of payment of tax

Under the proposal, an individual is permitted to elect to defer payment of the mark-to-market tax imposed on the deemed sale of the property. Interest is charged for the period the tax is deferred at a rate two percentage points higher than the rate normally applicable to individual underpayments. Under this election, the mark-to-market tax attributable to a particular property is due when the property is disposed of (or, if the property is disposed of in whole or in part in a nonrecognition transaction, at such other time as the Secretary may prescribe). The mark-to-market tax attributable to a particular property is an amount that bears the same ratio to the total mark-to-market tax for the

[151] Application of the provision is not limited to an interest that meets the definition of property under section 83 (relating to property transferred in connection with the performance of services).

year as the gain taken into account with respect to such property bears to the total gain taken into account under these rules for the year. The deferral of the mark-to-market tax may not be extended beyond the individual's death.

In order to elect deferral of the mark-to-market tax, the individual is required to provide adequate security to the Treasury to ensure that the deferred tax and interest will be paid. Other security mechanisms are permitted provided that the individual establishes to the satisfaction of the Secretary that the security is adequate. In the event that the security provided with respect to a particular property subsequently becomes inadequate and the individual fails to correct the situation, the deferred tax and the interest with respect to such property will become due. As a further condition to making the election, the individual is required to consent to the waiver of any treaty rights that would preclude the collection of the tax.

The deferred amount (including any interest, penalties, and certain other items) shall be a lien in favor of the United States on all U.S.-situs property owned by the individual. This lien shall arise on the expatriation date and shall continue until the tax liability is satisfied, the tax liability has become unenforceable by reason of lapse of time, or the Secretary is satisfied that no further tax liability may arise by reason of this proposal. The rules of section 6324A(d)(1), (3), and (4) (relating to liens arising in connection with the deferral of estate tax under section 6166) apply to liens arising under this proposal.

Interests in trusts

Under the proposal, detailed rules apply to trust interests held by an individual at the time of relinquishment of citizenship or termination of residency. The treatment of trust interests depends on whether the trust is a qualified trust. A trust is a qualified trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.

Constructive ownership rules apply to a trust beneficiary that is a corporation, partnership, trust, or estate. In such cases, the shareholders, partners, or beneficiaries of the entity are deemed to be the direct beneficiaries of the trust for purposes of applying these proposals. In addition, an individual who holds (or who is treated as holding) a trust instrument at the time of relinquishment of citizenship or termination of residency is required to disclose on his or her tax return the methodology used to determine his or her interest in the trust, and whether such individual knows (or has reason to know) that any other beneficiary of the trust uses a different method.

Nonqualified trusts.–If an individual holds an interest in a trust that is not a qualified trust, a special rule applies for purposes of determining the amount of the mark-to-market tax due with respect to such trust interest. The individual's interest in the trust is treated as a separate trust consisting of the trust assets allocable to such interest. Such separate trust is treated as having sold its net assets as of the date of relinquishment of citizenship or termination of residency and having distributed the assets to the individual,

who then is treated as having recontributed the assets to the trust. The individual is subject to the mark-to-market tax with respect to any net income or gain arising from the deemed distribution from the trust.

The election to defer payment is available for the mark-to-market tax attributable to a nonqualified trust interest. Interest is charged for the period the tax is deferred at a rate two percentage points higher than the rate normally applicable to individual underpayments. A beneficiary's interest in a nonqualified trust is determined under all the facts and circumstances, including the trust instrument, letters of wishes, and historical patterns of trust distributions.

Qualified trusts.–If an individual has an interest in a qualified trust, the amount of unrealized gain allocable to the individual's trust interest is calculated at the time of expatriation or residency termination. In determining this amount, all contingencies and discretionary interests are assumed to be resolved in the individual's favor (i.e., the individual is allocated the maximum amount that he or she could receive). The mark-to-market tax imposed on such gains is collected when the individual receives distributions from the trust, or if earlier, upon the individual's death. Interest is charged for the period the tax is deferred at a rate two percentage points higher than the rate normally applicable to individual underpayments.

If an individual has an interest in a qualified trust, the individual is subject to the mark-to-market tax upon the receipt of distributions from the trust. These distributions also may be subject to other U.S. income taxes. If a distribution from a qualified trust is made after the individual relinquishes citizenship or terminates residency, the mark-to-market tax is imposed in an amount equal to the amount of the distribution multiplied by the highest tax rate generally applicable to trusts and estates, but in no event will the tax imposed exceed the deferred tax amount with respect to the trust interest. For this purpose, the deferred tax amount is equal to (1) the tax calculated with respect to the unrealized gain allocable to the trust interest at the time of expatriation or residency termination, (2) increased by interest thereon, and (3) reduced by any mark-to-market tax imposed on prior trust distributions to the individual.

If any individual's interest in a trust is vested as of the expatriation date (e.g., if the individual's interest in the trust is non-contingent and non-discretionary), the gain allocable to the individual's trust interest is determined based on the trust assets allocable to his or her trust interest. If the individual's interest in the trust is not vested as of the expatriation date (e.g., if the individual's trust interest is a contingent or discretionary interest), the gain allocable to his or her trust interest is determined based on all of the trust assets that could be allocable to his or her trust interest, determined by resolving all contingencies and discretionary powers in the individual's favor. In the case where more than one trust beneficiary is subject to the expatriation tax with respect to trust interests that are not vested, the rules are intended to apply so that the same unrealized gain with respect to assets in the trust is not taxed to both individuals.

Mark-to-market taxes become due if the trust ceases to be a qualified trust, the individual disposes of his or her qualified trust interest, or the individual dies. In such

cases, the amount of mark-to-market tax equals the lesser of (1) the tax calculated under the rules for nonqualified trust interests as of the date of the triggering event, or (2) the deferred tax amount with respect to the trust interest as of that date.

The tax that is imposed on distributions from a qualified trust generally is deducted and withheld by the trustees. If the individual does not agree to waive treaty rights that would preclude collection of the tax, the tax with respect to such distributions is imposed on the trust, the trustee is personally liable for the tax, and any other beneficiary has a right of contribution against such individual with respect to the tax. Similar rules apply when the qualified trust interest is disposed of, the trust ceases to be a qualified trust, or the individual dies.

Coordination with present-law alternative tax regime

The proposal provides a coordination rule with the present-law alternative tax regime. Under the proposal, the expatriation income tax rules under section 877, and the expatriation estate and gift tax rules under sections 2107 and 2501(a)(3) (described above), do not apply to a former citizen or former long-term resident whose expatriation or residency termination occurs on or after February 5, 2003.

Treatment of gifts and inheritances from a former citizen or former long-term resident

Under the proposal, the exclusion from income provided in section 102 (relating to exclusions from income for the value of property acquired by gift or inheritance) does not apply to the value of any property received by gift or inheritance from a former citizen or former long-term resident (i.e., an individual who relinquished U.S. citizenship or terminated U.S. residency), subject to the exceptions described above relating to certain dual citizens and minors. Accordingly, a U.S. taxpayer who receives a gift or inheritance from such an individual is required to include the value of such gift or inheritance in gross income and is subject to U.S. tax on such amount. Having included the value of the property in income, the recipient would then take a basis in the property equal to that value. The tax does not apply to property that is shown on a timely filed gift tax return and that is a taxable gift by the former citizen or former long-term resident, or property that is shown on a timely filed estate tax return and included in the gross U.S. estate of the former citizen or former long-term resident (regardless of whether the tax liability shown on such a return is reduced by credits, deductions, or exclusions available under the estate and gift tax rules). In addition, the tax does not apply to property in cases in which no estate or gift tax return is required to be filed, where no such return would have been required to be filed if the former citizen or former long-term resident had not relinquished citizenship or terminated residency, as the case may be. Applicable gifts or bequests that are made in trust are treated as made to the beneficiaries of the trust in proportion to their respective interests in the trust.

Information reporting

The proposal provides that certain information reporting requirements under present law (sec. 6039G) applicable to former citizens and former long-term residents also apply for purposes of the proposal.

Immigration rules

The proposal amends the immigration rules that deny tax-motivated expatriates reentry into the United States by removing the requirement that the expatriation be tax-motivated, and instead denies former citizens reentry into the United States if the individual is determined not to be in compliance with his or her tax obligations under the proposal's expatriation tax proposals (regardless of the subjective motive for expatriating). For this purpose, the proposal permits the IRS to disclose certain items of return information of an individual, upon written request of the Attorney General or his delegate, as is necessary for making a determination under section 212(a)(10)(E) of the Immigration and Nationality Act. Specifically, the proposal would permit the IRS to disclose to the agency administering section 212(a)(10)(E) whether such taxpayer is in compliance with section 877A and identify the items of noncompliance. Recordkeeping requirements, safeguards, and civil and criminal penalties for unauthorized disclosure or inspection would apply to return information disclosed under this proposal.

Effective Date

The proposal generally is effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after February 5, 2003. The provisions relating to gifts and inheritances are effective for gifts and inheritances received from former citizens and former long-term residents on or after February 5, 2003, whose expatriation or residency termination occurs on or after such date. The provisions relating to former citizens under U.S. immigration laws are effective on or after the date of enactment.

E. Extension of IRS User Fees

Present Law

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104-117[152] extended the statutory authorization for these user fees[153] through September 30, 2003.

Description of Proposal

The proposal extends the statutory authorization for these user fees through September 30, 2013. The proposal also moves the statutory authorization for these fees into the Code.[154]

Effective Date

The proposal, including moving the statutory authorization for these fees into the Code and repealing the off-Code statutory authorization for these fees, is effective for requests made after the date of enactment.

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[152] An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996).

[153] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Pub. Law No. 100-203, December 22, 1987).

[154] The proposal also moves into the Code the user fee provision relating to pension plans that was enacted in section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. 107-16, June 7, 2001).

F. Provisions to Discourage Corporate Expatriation

1. Tax treatment of inversion transactions

Present Law

Determination of corporate residence

The U.S. tax treatment of a multinational corporate group depends significantly on whether the top-tier "parent" corporation of the group is domestic or foreign. For purposes of U.S. tax law, a corporation is treated as domestic if it is incorporated under the law of the United States or of any State. All other corporations (i.e., those incorporated under the laws of foreign countries) are treated as foreign. Thus, place of incorporation determines whether a corporation is treated as domestic or foreign for purposes of U.S. tax law, irrespective of other factors that might be thought to bear on a corporation's "nationality," such as the location of the corporation's management activities, employees, business assets, operations, or revenue sources, the exchanges on which the corporation's stock is traded, or the residence of the corporation's managers and shareholders.

U.S. taxation of domestic corporations

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. In order to mitigate the double taxation that may arise from taxing the foreign-source income of a domestic corporation, a foreign tax credit for income taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income is generally deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F[155] and the passive foreign investment company rules.[156] A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether repatriated as an actual dividend or included under one of the anti-deferral regimes.

U.S. taxation of foreign corporations

The United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income

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[155] Secs. 951-964.

[156] Secs. 1291-1298.

that is "effectively connected" with the conduct of a trade or business in the United States. Such "effectively connected income" generally is taxed in the same manner and at the same rates as the income of a U.S. corporation. An applicable tax treaty may limit the imposition of U.S. tax on business operations of a foreign corporation to cases in which the business is conducted through a "permanent establishment" in the United States.

In addition, foreign corporations generally are subject to a gross-basis U.S. tax at a flat 30-percent rate on the receipt of interest, dividends, rents, royalties, and certain similar types of income derived from U.S. sources, subject to certain exceptions. The tax generally is collected by means of withholding by the person making the payment. This tax may be reduced or eliminated under an applicable tax treaty.

U.S. tax treatment of inversion transactions

Under present law, U.S. corporations may reincorporate in foreign jurisdictions and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions are commonly referred to as "inversion" transactions. Inversion transactions may take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two. Most of the known transactions to date have been stock inversions. In one example of a stock inversion, a U.S. corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. corporation, with the U.S. corporation surviving, now as a subsidiary of the new foreign corporation. The U.S. corporation's shareholders receive shares of the foreign corporation and are treated as having exchanged their U.S. corporation shares for the foreign corporation shares. An asset inversion reaches a similar result, but through a direct merger of the top-tier U.S. corporation into a new foreign corporation, among other possible forms. An inversion transaction may be accompanied or followed by further restructuring of the corporate group. For example, in the case of a stock inversion, in order to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation may transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations.

In addition to removing foreign operations from the U.S. taxing jurisdiction, the corporate group may derive further advantage from the inverted structure by reducing U.S. tax on U.S.-source income through various "earnings stripping" or other transactions. This may include earnings stripping through payment by a U.S. corporation of deductible amounts such as interest, royalties, rents, or management service fees to the new foreign parent or other foreign affiliates. In this respect, the post-inversion structure enables the group to employ the same tax-reduction strategies that are available to other multinational corporate groups with foreign parents and U.S. subsidiaries, subject to the same limitations. These limitations under present law include section 163(j), which limits the deductibility of certain interest paid to related parties, if the payor's debt-equity ratio exceeds 1.5 to 1 and the payor's net interest expense exceeds 50 percent of its "adjusted taxable income." More generally, section 482 and the regulations thereunder require that all transactions between related parties be conducted on terms consistent with an "arm's length" standard, and permit the Secretary of the Treasury to reallocate income and deductions among such parties if that standard is not met.

Inversion transactions may give rise to immediate U.S. tax consequences at the shareholder and/or the corporate level, depending on the type of inversion. In stock inversions, the U.S. shareholders generally recognize gain (but not loss) under section 367(a), based on the difference between the fair market value of the foreign corporation shares received and the adjusted basis of the domestic corporation stock exchanged. To the extent that a corporation's share value has declined, and/or it has many foreign or tax-exempt shareholders, the impact of this section 367(a) "toll charge" is reduced. The transfer of foreign subsidiaries or other assets to the foreign parent corporation also may give rise to U.S. tax consequences at the corporate level (e.g., gain recognition and earnings and profits inclusions under sections 1001, 311(b), 304, 367, 1248 or other provisions). The tax on any income recognized as a result of these restructurings may be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

In asset inversions, the U.S. corporation generally recognizes gain (but not loss) under section 367(a) as though it had sold all of its assets, but the shareholders generally do not recognize gain or loss, assuming the transaction meets the requirements of a reorganization under section 368.

Description of Proposal

In general

The proposal defines two different types of corporate inversion transactions and establishes a different set of consequences for each type. Certain partnership transactions also are covered.

Transactions involving at least 80 percent identity of stock ownership

The first type of inversion is a transaction in which, pursuant to a plan or a series of related transactions: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity;[157] (2) the former shareholders of the U.S. corporation hold (by reason of holding stock in the U.S. corporation) 80 percent or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (i.e., the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. The provision denies the intended tax benefits of this type of inversion by deeming the top-tier foreign corporation to be a domestic corporation for all purposes of the Code.[158]

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[157] It is expected that the Treasury Secretary will issue regulations applying the term "substantially all" in this context and will not be bound in this regard by interpretations of the term in other contexts under the Code.

[158] Since the top-tier foreign corporation is treated for all purposes of the Code as domestic, the shareholder-level "toll charge" of sec. 367(a) does not apply to these inversion transactions. However, with respect to inversion transactions completed before 2004, regulated

Except as otherwise provided in regulations, the provision does not apply to a direct or indirect acquisition of the properties of a U.S. corporation no class of the stock of which was traded on an established securities market at any time within the four-year period preceding the acquisition. In determining whether a transaction would meet the definition of an inversion under the provision, stock held by members of the expanded affiliated group that includes the foreign incorporated entity is disregarded. For example, if the former top-tier U.S. corporation receives stock of the foreign incorporated entity (e.g., so-called "hook" stock), the stock would not be considered in determining whether the transaction meets the definition. Stock sold in a public offering (whether initial or secondary) or private placement related to the transaction also is disregarded for these purposes. Acquisitions with respect to a domestic corporation or partnership are deemed to be "pursuant to a plan" if they occur within the four-year period beginning on the date which is two years before the ownership threshold under the provision is met with respect to such corporation or partnership.

Transfers of properties or liabilities as part of a plan a principal purpose of which is to avoid the purposes of the provision are disregarded. In addition, the Treasury Secretary is granted authority to prevent the avoidance of the purposes of the provision, including avoidance through the use of related persons, pass-through or other noncorporate entities, or other intermediaries, and through transactions designed to qualify or disqualify a person as a related person, a member of an expanded affiliated group, or a publicly traded corporation. Similarly, the Treasury Secretary is granted authority to treat certain non-stock instruments as stock, and certain stock as not stock, where necessary to carry out the purposes of the provision.

Transactions involving greater than 50 percent but less than 80 percent identity of stock ownership

The second type of inversion is a transaction that would meet the definition of an inversion transaction described above, except that the 80-percent ownership threshold is not met. In such a case, if a greater-than-50-percent ownership threshold is met, then a second set of rules applies to the inversion. Under these rules, the inversion transaction is respected (i.e., the foreign corporation is treated as foreign), but: (1) any applicable corporate-level "toll charges" for establishing the inverted structure may not be offset by tax attributes such as net operating losses or foreign tax credits; (2) the IRS is given expanded authority to monitor related-party transactions that may be used to reduce U.S. tax on U.S.-source income going forward; and (3) section 163(j), relating to "earnings stripping" through related-party debt, is strengthened. These measures generally apply for a 10-year period following the inversion transaction. In addition, inverting entities are required to provide information to shareholders or partners and the IRS with respect to the inversion transaction.

With respect to "toll charges," any applicable corporate-level income or gain required to be recognized under sections 304, 311(b), 367, 1001, 1248, or any other provision with respect to the transfer of controlled foreign corporation stock or other assets by a U.S. corporation as part of the inversion transaction or after such transaction to a related foreign person is taxable,

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investment companies and certain similar entities are allowed to elect to recognize gain as if sec. 367(a) did apply.

without offset by any tax attributes (e.g., net operating losses or foreign tax credits). To the extent provided in regulations, this rule will not apply to certain transfers of inventory and similar transactions conducted in the ordinary course of the taxpayer's business.

In order to enhance IRS monitoring of related-party transactions, the provision establishes a new pre-filing procedure. Under this procedure, the taxpayer will be required annually to submit an application to the IRS for an agreement that all return positions to be taken by the taxpayer with respect to related-party transactions comply with all relevant provisions of the Code, including sections 163(j), 267(a)(3), 482, and 845. The Treasury Secretary is given the authority to specify the form, content, and supporting information required for this application, as well as the timing for its submission.

The IRS will be required to take one of the following three actions within 90 days of receiving a complete application from a taxpayer: (1) conclude an agreement with the taxpayer that the return positions to be taken with respect to related-party transactions comply with all relevant provisions of the Code; (2) advise the taxpayer that the IRS is satisfied that the application was made in good faith and substantially complies with the requirements set forth by the Treasury Secretary for such an application, but that the IRS reserves substantive judgment as to the tax treatment of the relevant transactions pending the normal audit process; or (3) advise the taxpayer that the IRS has concluded that the application was not made in good faith or does not substantially comply with the requirements set forth by the Treasury Secretary.

In the case of a compliance failure described in (3) above (and in cases in which the taxpayer fails to submit an application), the following sanctions will apply for the taxable year for which the application was required: (1) no deductions or additions to basis or cost of goods sold for payments to foreign related parties will be permitted; (2) any transfers or licenses of intangible property to related foreign parties will be disregarded; and (3) any cost-sharing arrangements will not be respected. In such a case, the taxpayer may seek direct review by the U.S. Tax Court of the IRS's determination of compliance failure.

If the IRS fails to act on the taxpayer's application within 90 days of receipt, then the taxpayer will be treated as having submitted in good faith an application that substantially complies with the above-referenced requirements. Thus, the deduction disallowance and other sanctions described above will not apply, but the IRS will be able to examine the transactions at issue under the normal audit process. The IRS is authorized to request that the taxpayer extend this 90-day deadline in cases in which the IRS believes that such an extension might help the parties to reach an agreement.

The "earnings stripping" rules of section 163(j), which deny or defer deductions for certain interest paid to foreign related parties, are strengthened for inverted corporations. With respect to such corporations, the provision eliminates the debt-equity threshold generally applicable under section 163(j) and reduces the 50-percent thresholds for "excess interest expense" and "excess limitation" to 25 percent.

In cases in which a U.S. corporate group acquires subsidiaries or other assets from an unrelated inverted corporate group, the provisions described above generally do not apply to the acquiring U.S. corporate group or its related parties (including the newly acquired subsidiaries or

assets) by reason of acquiring the subsidiaries or assets that were connected with the inversion transaction. The Treasury Secretary is given authority to issue regulations appropriate to carry out the purposes of this provision and to prevent its abuse.

Partnership transactions

Under the proposal, both types of inversion transactions include certain partnership transactions. Specifically, both parts of the provision apply to transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership (whether or not publicly traded), if after the acquisition at least 80 percent (or more than 50 percent but less than 80 percent, as the case may be) of the stock of the entity is held by former partners of the partnership (by reason of holding their partnership interests), and the "substantial business activities" test is not met. For purposes of determining whether these tests are met, all partnerships that are under common control within the meaning of section 482 are treated as one partnership, except as provided otherwise in regulations. In addition, the modified "toll charge" provisions apply at the partner level.

Effective Date

The regime applicable to transactions involving at least 80 percent identity of ownership applies to inversion transactions completed after March 20, 2002. The rules for inversion transactions involving greater-than-50-percent identity of ownership apply to inversion transactions completed after 1996 that meet the 50-percent test and to inversion transactions completed after 1996 that would have met the 80-percent test but for the March 20, 2002 date.

2. Excise tax on stock compensation of insiders of inverted corporations

Present Law

The income taxation of a nonstatutory[159] compensatory stock option is determined under the rules that apply to property transferred in connection with the performance of services (sec. 83). If a nonstatutory stock option does not have a readily ascertainable fair market value at the time of grant, which is generally the case unless the option is actively traded on an established market, no amount is included in the gross income of the recipient with respect to the option until the recipient exercises the option.[160] Upon exercise of such an option, the excess of the fair market value of the stock purchased over the option price is included in the recipient's gross income as ordinary income in such taxable year.

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[159] Nonstatutory stock options refer to stock options other than incentive stock options and employee stock purchase plans, the taxation of which is determined under sections 421-424.

[160] If an individual receives a grant of a nonstatutory option that has a readily ascertainable fair market value at the time the option is granted, the excess of the fair market value of the option over the amount paid for the option is included in the recipient's gross income as ordinary income in the first taxable year in which the option is either transferable or not subject to a substantial risk of forfeiture.

The tax treatment of other forms of stock-based compensation (e.g., restricted stock and stock appreciation rights) is also determined under section 83. The excess of the fair market value over the amount paid (if any) for such property is generally includable in gross income in the first taxable year in which the rights to the property are transferable or are not subject to substantial risk of forfeiture.

Shareholders are generally required to recognize gain upon stock inversion transactions. An inversion transaction is generally not a taxable event for holders of stock options and other stock-based compensation.

Description of Proposal

Under the provision, specified holders of stock options and other stock-based compensation are subject to an excise tax upon certain inversion transactions. The provision imposes a 20 percent excise tax on the value of specified stock compensation held (directly or indirectly) by or for the benefit of a disqualified individual, or a member of such individual's family, at any time during the 12-month period beginning six months before the corporation's inversion date. Specified stock compensation is treated as held for the benefit of a disqualified individual if such compensation is held by an entity, e.g., a partnership or trust, in which the individual, or a member of the individual's family, has an ownership interest.

A disqualified individual is any individual who, with respect to a corporation, is, at any time during the 12-month period beginning on the date which is six months before the inversion date, subject to the requirements of section 16(a) of the Securities and Exchange Act of 1934 with respect to the corporation, or any member of the corporation's expanded affiliated group,[161] or would be subject to such requirements if the corporation (or member) were an issuer of equity securities referred to in section 16(a). Disqualified individuals generally include officers (as defined by section 16(a)),[162] directors, and 10-percent owners of private and publicly-held corporations.

The excise tax is imposed on a disqualified individual of an inverted corporation only if gain (if any) is recognized in whole or part by any shareholder by reason of either the 80 percent or 50 percent identity of stock ownership corporate inversion transactions previously described in the provision.

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[161] An expanded affiliated group is an affiliated group (under section 1504) except that such group is determined without regard to the exceptions for certain corporations and is determined applying a greater than 50 percent threshold, in lieu of the 80 percent test.

[162] An officer is defined as the president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions.

Specified stock compensation subject to the excise tax includes any payment[163] (or right to payment) granted by the inverted corporation (or any member of the corporation's expanded affiliated group) to any person in connection with the performance of services by a disqualified individual for such corporation (or member of the corporation's expanded affiliated group) if the value of the payment or right is based on, or determined by reference to, the value or change in value of stock of such corporation (or any member of the corporation's expanded affiliated group). In determining whether such compensation exists and valuing such compensation, all restrictions, other than non-lapse restrictions, are ignored. Thus, the excise tax applies, and the value subject to the tax is determined, without regard to whether such specified stock compensation is subject to a substantial risk of forfeiture or is exercisable at the time of the inversion transaction. Specified stock compensation includes compensatory stock and restricted stock grants, compensatory stock options, and other forms of stock-based compensation, including stock appreciation rights, phantom stock, and phantom stock options. Specified stock compensation also includes nonqualified deferred compensation that is treated as though it were invested in stock or stock options of the inverting corporation (or member). For example, the provision applies to a disqualified individual's deferred compensation if company stock is one of the actual or deemed investment options under the nonqualified deferred compensation plan.

Specified stock compensation includes a compensation arrangement that gives the disqualified individual an economic stake substantially similar to that of a corporate shareholder. Thus, the excise tax does not apply where a payment is simply triggered by a target value of the corporation's stock or where a payment depends on a performance measure other than the value of the corporation's stock. Similarly, the tax does not apply if the amount of the payment is not directly measured by the value of the stock or an increase in the value of the stock. For example, an arrangement under which a disqualified individual is paid a cash bonus of $500,000 if the corporation's stock increased in value by 25 percent over two years or $1,000,000 if the stock increased by 33 percent over two years is not specified stock compensation, even though the amount of the bonus generally is keyed to an increase in the value of the stock. By contrast, an arrangement under which a disqualified individual is paid a cash bonus equal to $10,000 for every $1 increase in the share price of the corporation's stock is subject to the provision because the direct connection between the compensation amount and the value of the corporation's stock gives the disqualified individual an economic stake substantially similar to that of a shareholder.

The excise tax applies to any such specified stock compensation previously granted to a disqualified individual but cancelled or cashed-out within the six-month period ending with the inversion transaction, and to any specified stock compensation awarded in the six-month period beginning with the inversion transaction. As a result, for example, if a corporation were to cancel outstanding options three months before the transaction and then reissue comparable options three months after the transaction, the tax applies both to the cancelled options and the newly granted options. It is intended that the Treasury Secretary issue guidance to avoid double counting with respect to specified stock compensation that is cancelled and then regranted during the applicable twelve-month period.

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[163] Under the provision, any transfer of property is treated as a payment and any right to a transfer of property is treated as a right to a payment.

Specified stock compensation subject to the tax does not include a statutory stock option or any payment or right from a qualified retirement plan or annuity, a tax-sheltered annuity, a simplified employee pension, or a simple retirement account. In addition, under the provision, the excise tax does not apply to any stock option that is exercised during the six-month period before the inversion or to any stock acquired pursuant to such exercise. The excise tax also does not apply to any specified stock compensation which is sold, exchanged, distributed or cashed-out during such period in a transaction in which gain or loss is recognized in full.

For specified stock compensation held on the inversion date, the amount of the tax is determined based on the value of the compensation on such date. The tax imposed on specified stock compensation cancelled during the six-month period before the inversion date is determined based on the value of the compensation on the day before such cancellation, while specified stock compensation granted after the inversion date is valued on the date granted. Under the provision, the cancellation of a non-lapse restriction is treated as a grant.

The value of the specified stock compensation on which the excise tax is imposed is the fair value in the case of stock options (including warrants and other similar rights to acquire stock) and stock appreciation rights and the fair market value for all other forms of compensation. For purposes of the tax, the fair value of an option (or a warrant or other similar right to acquire stock) or a stock appreciation right is determined using an appropriate option-pricing model, as specified or permitted by the Treasury Secretary, that takes into account the stock price at the valuation date; the exercise price under the option; the remaining term of the option; the volatility of the underlying stock and the expected dividends on it; and the risk-free interest rate over the remaining term of the option. Options that have no intrinsic value (or "spread") because the exercise price under the option equals or exceeds the fair market value of the stock at valuation nevertheless have a fair value and are subject to tax under the provision. The value of other forms of compensation, such as phantom stock or restricted stock, are the fair market value of the stock as of the date of the inversion transaction. The value of any deferred compensation that could be valued by reference to stock is the amount that the disqualified individual would receive if the plan were to distribute all such deferred compensation in a single sum on the date of the inversion transaction (or the date of cancellation or grant, if applicable). It is expected that the Treasury Secretary issue guidance on valuation of specified stock compensation, including guidance similar to the revenue procedures issued under section 280G, except that the guidance would not permit the use of a term other than the full remaining term. Pending the issuance of guidance, it is intended that taxpayers could rely on the revenue procedures issued under section 280G (except that the full remaining term must be used).

The excise tax also applies to any payment by the inverted corporation or any member of the expanded affiliated group made to an individual, directly or indirectly, in respect of the tax. Whether a payment is made in respect of the tax is determined under all of the facts and circumstances. Any payment made to keep the individual in the same after-tax position that the individual would have been in had the tax not applied is a payment made in respect of the tax. This includes direct payments of the tax and payments to reimburse the individual for payment of the tax. It is expected that the Treasury Secretary issue guidance on determining when a payment is made in respect of the tax and that such guidance would include certain factors that give rise to a rebuttable presumption that a payment is made in respect of the tax, including a rebuttable presumption that if the payment is contingent on the inversion transaction, it is made

in respect to the tax. Any payment made in respect of the tax is includible in the income of the individual, but is not deductible by the corporation.

To the extent that a disqualified individual is also a covered employee under section 162(m), the $1,000,000 limit on the deduction allowed for employee remuneration for such employee is reduced by the amount of any payment (including reimbursements) made in respect of the tax under the provision. As discussed above, this includes direct payments of the tax and payments to reimburse the individual for payment of the tax.

The payment of the excise tax has no effect on the subsequent tax treatment of any specified stock compensation. Thus, the payment of the tax has no effect on the individual's basis in any specified stock compensation and no effect on the tax treatment for the individual at the time of exercise of an option or payment of any specified stock compensation, or at the time of any lapse or forfeiture of such specified stock compensation. The payment of the tax is not deductible and has no effect on any deduction that might be allowed at the time of any future exercise or payment.

Under the provision, the Treasury Secretary is authorized to issue regulations as may be necessary or appropriate to carry out the purposes of the section.

Effective Date

The provision is effective as of July 11, 2002, except that periods before July 11, 2002, are not taken into account in applying the tax to specified stock compensation held or cancelled during the six-month period before the inversion date.

3. Reinsurance agreements

Present Law

In the case of a reinsurance agreement between two or more related persons, present law provides the Treasury Secretary with authority to allocate among the parties or recharacterize income (whether investment income, premium or otherwise), deductions, assets, reserves, credits and any other items related to the reinsurance agreement, or make any other adjustment, in order to reflect the proper source and character of the items for each party.[164] For this purpose, related persons are defined as in section 482. Thus, persons are related if they are organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) that are owned or controlled directly or indirectly by the same interests. The provision may apply to a contract even if one of the related parties is not a domestic company.[165] In addition, the provision also permits such allocation, recharacterization, or other adjustments in a case in which one of the parties to a reinsurance agreement is, with respect to

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[164] Sec. 845(a).

[165] See S. Rep. No. 97-494, "Tax Equity and Fiscal Responsibility Act of 1982," July 12, 1982, 337 (describing provisions relating to the repeal of modified coinsurance provisions).

any contract covered by the agreement, in effect an agent of another party to the agreement, or a conduit between related persons.

Description of Proposal

The proposal clarifies the rules of section 845, relating to authority for the Treasury Secretary to allocate items among the parties to a reinsurance agreement, recharacterize items, or make any other adjustment, in order to reflect the proper source and character of the items for each party. The proposal authorizes such allocation, recharacterization, or other adjustment, in order to reflect the proper source, character or amount of the item. It is intended that this authority[166] be exercised in a manner similar to the authority under section 482 for the Treasury Secretary to make adjustments between related parties. It is intended that this authority be applied in situations in which the related persons (or agents or conduits) are engaged in cross-border transactions that require allocation, recharacterization, or other adjustments in order to reflect the proper source, character or amount of the item or items. No inference is intended that present law does not provide this authority with respect to reinsurance agreements.

No regulations have been issued under section 845(a). It is expected that the Treasury Secretary will issue regulations under section 845(a) to address effectively the allocation of income (whether investment income, premium or otherwise) and other items, the recharacterization of such items, or any other adjustment necessary to reflect the proper amount, source or character of the item.

Effective Date

The provision is effective for any risk reinsured after April 11, 2002.

[166] The authority to allocate, recharacterize or make other adjustments was granted in connection with the repeal of provisions relating to modified coinsurance transactions.

G. Add Vaccines Against Hepatitis A to the List of Taxable Vaccines

Present Law

A manufacturer's excise tax is imposed at the rate of 75 cents per dose[167] on the following vaccines routinely recommended for administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, varicella (chicken pox), rotavirus gastroenteritis, and streptococcus pneumoniae. The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. This program provides a substitute Federal, "no fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers. All persons immunized after September 30, 1988, with covered vaccines must pursue compensation under this Federal program before bringing civil tort actions under State law.

Description of Proposal

The proposal adds any vaccine against hepatitis A to the list of taxable vaccines. The proposal also makes a conforming amendment to the trust fund expenditure purposes.

Effective Date

The proposal is effective for vaccines sold beginning on the first day of the first month beginning more than four weeks after the date of enactment.

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[167] Sec. 4131.

H. Disallowance of Certain Partnership Loss Transfers

Present Law

Contributions of property

Under present law, if a partner contributes property to a partnership, generally no gain or loss is recognized to the contributing partner at the time of contribution.[168] The partnership takes the property at an adjusted basis equal to the contributing partner's adjusted basis in the property.[169] The contributing partner increases its basis in its partnership interest by the adjusted basis of the contributed property.[170] Any items of partnership income, gain, loss and deduction with respect to the contributed property is allocated among the partners to take into account any built-in gain or loss at the time of the contribution.[171] This rule is intended to prevent the transfer of built-in gain or loss from the contributing partner to the other partners by generally allocating items to the noncontributing partners based on the value of their contributions and by allocating to the contributing partner the remainder of each item.[172]

If the contributing partner transfers its partnership interest, the built-in gain or loss will be allocated to the transferee partner as it would have been allocated to the contributing partner.[173] If the contributing partner's interest is liquidated, there is no specific guidance preventing the allocation of the built-in loss to the remaining partners. Thus, it appears that losses can be "transferred" to other partners where the contributing partner no longer remains a partner.

Transfers of partnership interests

Under present law, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless the partnership has made a one-time election under section 754 to make basis adjustments.[174] If an election is in effect, adjustments are made with respect to the transferee partner in order to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the

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[168] Sec. 721.

[169] Sec. 723.

[170] Sec. 722

[171] Sec. 704(c)(1)(A).

[172] Where there is an insufficient amount of an item to allocate to the noncontributing partners, Treasury regulations allow for reasonable allocations to remedy this insufficiency. Treas. Reg. sec. 1-704(c) and (d).

[173] Treas. Reg. 1.704-3(a)(7).

[174] Sec. 743(a).

transferee's basis in its partnership interest.[175] These adjustments are intended to adjust the basis of partnership property to approximate the result of a direct purchase of the property by the transferee partner. Under these rules, if a partner purchases an interest in a partnership with an existing built-in loss and no election under section 754 in effect, the transferee partner may be allocated a share of the loss when the partnership disposes of the property (or depreciates the property).

Distributions of partnership property

With certain exceptions, partners may receive distributions of partnership property without recognition of gain or loss by either the partner or the partnership.[176] In the case of a distribution in liquidation of a partner's interest, the basis of the property distributed in the liquidation is equal to the partner's adjusted basis in its partnership interest (reduced by any money distributed in the transaction).[177] In a distribution other than in liquidation of a partner's interest, the distributee partner's basis in the distributed property is equal to the partnership's adjusted basis in the property immediately before the distribution, but not to exceed the partner's adjusted basis in the partnership interest (reduced by any money distributed in the same transaction).[178]

Adjustments to the basis of the partnership's undistributed properties are not required unless the partnership has made the election under section 754 to make basis adjustments.[179] If an election is in effect under section 754, adjustments are made by a partnership to increase or decrease the remaining partnership assets to reflect any increase or decrease in the adjusted basis of the distributed properties in the hands of the distributee partner.[180] To the extent the adjusted basis of the distributed properties increases (or loss is recognized) the partnership's adjusted basis in its properties is decreased by a like amount; likewise, to the extent the adjusted basis of the distributed properties decrease (or gain is recognized), the partnership's adjusted basis in its properties is increased by a like amount. Under these rules, a partnership with no election in effect under section 754 may distribute property with an adjusted basis lower than the distributee partner's proportionate share of the adjusted basis of all partnership property and leave the remaining partners with a smaller net built-in gain or a larger net built-in loss than before the distribution.

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[175] Sec. 743(b).

[176] Sec. 731(a) and (b).

[177] Sec. 732(b).

[178] Sec. 732(a).

[179] Sec. 734(a).

[180] Sec. 734(b).

Description of Proposal

Contributions of property

Under the proposal, a built-in loss may be taken into account only by the contributing partner and not by other partners. Except as provided in regulations, in determining the amount of items allocated to partners other than the contributing partner, the basis of the contributed property is treated as the fair market value on the date of contribution. Thus, if the contributing partner's partnership interest is transferred or liquidated, the partnership's adjusted basis in the property is based on its fair market value at the date of contribution, and the built-in loss will be eliminated.[181]

Transfers of partnership interests

The proposal provides that the basis adjustment rules under section 743 are in the case of the transfer of a partnership interest with respect to which there is a substantial built-in loss (rather than being elective as under present law). For this purpose, a substantial built-in loss exists if the transferee partner's proportionate share of the adjusted basis of the partnership property exceeds by more than $250,000 the transferee partner's basis in the partnership interest in the partnership.

Thus, for example, assume that partner A sells his partnership interest to B for its fair market value of $1 million. Also assume that B's proportionate share of the adjusted basis of the partnership assets is $1.3 million. Under the bill, section 743(b) applies, so that a $300,000 decrease is required to the adjusted basis of the partnership assets with respect to B. As a result, B would recognize no gain or loss if the partnership immediately sold all its assets for their fair market value.

Distribution of partnership property

The proposal provides that the basis adjustments under section 734 are required in the case of a distribution with respect to which there is a substantial basis reduction. A substantial basis reduction means a downward adjustment of more that $250,000 that would be made to the basis of partnership assets if a section 754 election were in effect.

Thus, for example, assume that A and B each contributed $2.5 million to a newly formed partnership and C contributed $5 million, and that the partnership purchased LMN stock for $3 million and XYZ stock for $7 million. Assume that the value of each stock declined to $1 million. Assume LMN stock is distributed to C in liquidation of its partnership interest. As under present law, the basis of LMN stock in C's hands is $5 million. Under present law, C would recognize a loss of $4 million if the LMN stock were sold for $1 million.

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[181] It is intended that a corporation succeeding to attributes of the contributing corporate partner under section 381 shall be treated in the same manner as the contributing partner.

Under the proposal, however, there is a substantial basis adjustment because the $2 million increase in the adjusted basis of LMN stock (sec. 734(b)(2)(B)) is greater than $250,000. Thus, the partnership is required to decrease the basis of XYZ stock (under section 734(b)(2)) by $2 million (the amount by which the basis LMN stock was increased), leaving a basis of $5 million. If the XYZ stock were then sold by the partnership for $1 million, A and B would each recognize a loss of $2 million.

Effective Date

The proposal applies to contributions, transfers, and distributions (as the case may be) after the date of enactment.

I. Treatment of Stripped Bonds to Apply to Stripped Interests in Bond and Preferred Stock Funds

Present Law

Assignment of income in general

In general, an "income stripping" transaction involves a transaction in which the right to receive future income from income-producing property is separated from the property itself. In such transactions, it may be possible to generate artificial losses from the disposition of certain property or to defer the recognition of taxable income associated with such property.

Common law has developed a rule (referred to as the "assignment of income" doctrine) that income may not be transferred without also transferring the underlying property. A leading judicial decision relating to the assignment of income doctrine involved a case in which a taxpayer made a gift of detachable interest coupons before their due date while retaining the bearer bond. The U.S. Supreme Court ruled that the donor was taxable on the entire amount of interest when paid to the donee on the grounds that the transferor had "assigned" to the donee the right to receive the income.[182]

In addition to general common law assignment of income principles, specific statutory rules have been enacted to address certain specific types of stripping transactions, such as transactions involving stripped bonds and stripped preferred stock (which are discussed below).[183] However, there are no specific statutory rules that address stripping transactions with respect to common stock or other equity interests (other than preferred stock).[184]

Both the scope of the assignment of income doctrine and the extent to which the doctrine has been overruled by the subsequent enactment of specific statutory income stripping rules is unclear.

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[182] *Helvering v. Horst*, 311 U.S. 112 (1940).

[183] Depending on the facts, the IRS also could determine that a variety of other Code-based and common law-based authorities could apply to income stripping transactions, including: (1) sections 269, 382, 446(b), 482, 701, or 704 and the regulations thereunder; (2) authorities that recharacterize certain assignments or accelerations of future payments as financings; (3) business purpose, economic substance, and sham transaction doctrines; (4) the step transaction doctrine; and (5) the substance-over-form doctrine. *See* Notice 95-53, 1995-2 C.B. 334 (accounting for lease strips and other stripping transactions).

[184] However, in *Estate of Stranahan v. Commissioner*, 472 F.2d 867 (6th Cir. 1973), the court held that where a taxpayer sold a carved-out interest of stock dividends, with no personal obligation to produce the income, the transaction was treated as a sale of an income interest.

Stripped bonds

Special rules are provided with respect to the purchaser and "stripper" of stripped bonds.[185] A "stripped bond" is defined as a debt instrument in which there has been a separation in ownership between the underlying debt instrument and any interest coupon that has not yet become payable.[186] In general, upon the disposition of either the stripped bond or the detached interest coupons, the retained portion and the portion that is disposed of each is treated as a new bond that is purchased at a discount and is payable at a fixed amount on a future date. Accordingly, section 1286 treats both the stripped bond and the detached interest coupons as individual bonds that are newly issued with original issue discount ("OID") on the date of disposition. Consequently, section 1286 effectively subjects the stripped bond and the detached interest coupons to the general OID periodic income inclusion rules.

A taxpayer who purchases a stripped bond or one or more stripped coupons is treated as holding a new bond that is issued on the purchase date with OID in an amount that is equal to the excess of the stated redemption price at maturity (or in the case of a coupon, the amount payable on the due date) over the ratable share of the purchase price of the stripped bond or coupon, determined on the basis of the respective fair market values of the stripped bond and coupons on the purchase date.[187] The OID on the stripped bond or coupon is includible in gross income under the general OID periodic income inclusion rules.

A taxpayer who strips a bond and disposes of either the stripped bond or one or more stripped coupons must allocate his basis, immediately before the disposition, in the bond (with the coupons attached) between the retained and disposed items.[188] Special rules apply to require that interest or market discount accrued on the bond prior to such disposition must be included in the taxpayer's gross income (to the extent that it had not been previously included in income) at the time the stripping occurs, and the taxpayer increases his basis in the bond by the amount of such accrued interest or market discount. The adjusted basis (as increased by any accrued interest or market discount) is then allocated between the stripped bond and the stripped interest coupons in relation to their respective fair market values. Amounts realized from the sale of stripped coupons or bonds constitute income to the taxpayer only to the extent such amounts exceed the basis allocated to the stripped coupons or bond. With respect to retained items (either the detached coupons or stripped bond), to the extent that the price payable on maturity, or on the due date of the coupons, exceeds the portion of the taxpayer's basis allocable to such retained

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[185] Section 1286.

[186] Section 1286(e).

[187] Section 1286(a).

[188] Section 1286(b). Similar rules apply in the case of any person whose basis in any bond or coupon is determined by reference to the basis in the hands of a person who strips the bond.

items, the difference is treated as OID that is required to be included under the general OID periodic income inclusion rules.[189]

Stripped preferred stock

"Stripped preferred stock" is defined as preferred stock in which there has been a separation in ownership between such stock and any dividend on such stock that has not become payable.[190] A taxpayer who purchases stripped preferred stock is required to include in gross income, as ordinary income, the amounts that would have been includible if the stripped preferred stock was a bond issued on the purchase date with OID equal to the excess of the redemption price of the stock over the purchase price.[191] This treatment is extended to any taxpayer whose basis in the stock is determined by reference to the basis in the hands of the purchaser. A taxpayer who strips and disposes the future dividends is treated as having purchased the stripped preferred stock on the date of such disposition for a purchase price equal to the taxpayer's adjusted basis in the stripped preferred stock.[192]

Description of Proposal

The proposal authorizes the Treasury Department to promulgate regulations that, in appropriate cases, apply rules that are similar to the present-law rules for stripped bonds and stripped preferred stock to direct or indirect interests in an entity or account substantially all of the assets of which consist of bonds (as defined in section 1286(e)(1)), preferred stock (as defined in section 305(e)(5)(B)), or any combination thereof. The proposal applies only to cases in which the present-law rules for stripped bonds and stripped preferred stock do not already apply to such interests.

For example, such Treasury regulations could apply to a transaction in which a person effectively strips future dividends from shares in a money market mutual fund (and disposes either the stripped shares or stripped future dividends) by contributing the shares (with the future dividends) to a custodial account through which another person purchases rights to either the stripped shares or the stripped future dividends. However, it is intended that Treasury regulations issued under this proposal would not apply to certain transactions involving direct or indirect interests in an entity or account substantially all the assets of which consist of tax-exempt obligations (as defined in section 1275(a)(3)), such as a tax-exempt bond partnership described in Rev. Proc. 2002-68, 2002-43 I.R.B. 753, *modifying and superceding* Rev. Proc. 2002-16, 2002-9 I.R.B. 572.

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[189] Special rules are provided with respect to stripping transactions involving tax-exempt obligations that treat OID (computed under the stripping rules) in excess of OID computed on the basis of the bond's coupon rate (or higher rate if originally issued at a discount) as income from a non-tax-exempt debt instrument (sec. 1286(d)).

[190] Section 305(e)(5).

[191] Section 305(e)(1).

[192] Section 305(e)(3).

No inference is intended as to the treatment under the present-law rules for stripped bonds and stripped preferred stock, or under any other provisions or doctrines of present law, of interests in an entity or account substantially all of the assets of which consist of bonds, preferred stock, or any combination thereof. The Treasury regulations, when issued, would be applied prospectively, except in cases to prevent abuse.

Effective Date

The proposal is effective for purchases and dispositions occurring after the date of enactment.

J. Reporting of Taxable Mergers and Acquisitions

Present Law

Under section 6045 and the regulations thereunder, brokers (defined to include stock transfer agents) are required to make information returns and to provide corresponding payee statements as to sales made on behalf of their customers, subject to the penalty provisions of sections 6721-6724. Under the regulations issued under section 6045, this requirement generally does not apply with respect to taxable transactions other than exchanges for cash (e.g., stock inversion transactions taxable to shareholders by reason of section 367(a)).

Description of Proposal

Under the proposal, if gain or loss is recognized in whole or in part by shareholders of a corporation by reason of a second corporation's acquisition of the stock or assets of the first corporation, then the acquiring corporation (or the acquired corporation, if so prescribed by the Treasury Secretary) is required to make a return containing:

(1) A description of the transaction;

(2) The name and address of each shareholder of the acquired corporation that recognizes gain as a result of the transaction (or would recognize gain, if there was a built-in gain on the shareholder's shares);

(3) The amount of money and the value of stock or other consideration paid to each shareholder described above; and

(4) Such other information as the Treasury Secretary may prescribe.

Alternatively, a stock transfer agent who records transfers of stock in such transaction may make the return described above in lieu of the second corporation.

In addition, every person required to make a return described above is required to furnish to each shareholder whose name is required to be set forth in such return a written statement showing:

(1) The name, address, and phone number of the information contact of the person required to make such return;

(2) The information required to be shown on that return; and

(3) Such other information as the Treasury Secretary may prescribe.

This written statement is required to be furnished to the shareholder on or before January 31 of the year following the calendar year during which the transaction occurred.

The present-law penalties for failure to comply with information reporting requirements are extended to failures to comply with the requirements set forth under this proposal.

Effective Date

The proposal is effective for acquisitions after the date of enactment of the proposal.

K. Inclusion in Gross Income of Certain Deferred Compensation

Present Law

The determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the individual earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine,[193] the provisions of section 83 relating generally to transfers of property in connection with the performance of services, and provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)).

In general, the time for income inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received. If the arrangement is funded, then income is includible for the year in which the individual's rights are transferable or not subject to a substantial risk of forfeiture.

Nonqualified deferred compensation is generally subject to social security and Medicare tax when it is earned (i.e., when services are performed), unless the nonqualified deferred compensation is subject to a substantial risk of forfeiture. If nonqualified deferred compensation is subject to a substantial risk of forfeiture, it is subject to social security and Medicare tax when the risk of forfeiture is removed (i.e., when the right to the nonqualified deferred compensation vests). This treatment is not affected by whether the arrangement is funded or unfunded, which is relevant in determining when amounts are includible in income (and subject to income tax withholding).

In general, an arrangement is considered funded if there has been a transfer of property under section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of section 83.[194] Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor, for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. On the other hand, deferred amounts are generally not includible in income in situations where nonqualified deferred compensation is payable from general corporate funds

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[193] *See, e.g., Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952); Rev. Rul. 60-31, 1960-1 C.B. 174.

[194] Treas. Reg. sec. 1.83-3(e). This definition in part reflects previous IRS rulings on nonqualified deferred compensation.

that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

As discussed above, if the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received under section 451. Income is constructively received when it is credited to an individual's account, set apart, or otherwise made available so that it can be drawn on at any time. Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. A requirement to relinquish a valuable right in order to make withdrawals is generally treated as a substantial limitation or restriction.

Special statutory provisions govern the timing of the deduction for nonqualified deferred compensation, regardless of whether the arrangement covers employees or nonemployees and regardless of whether the arrangement is funded or unfunded.[195] Under these provisions, the amount of nonqualified deferred compensation that is includible in the income of the individual performing services is deductible by the service recipient for the taxable year in which the amount is includible in the individual's income.

Rabbi trusts

Arrangements have developed in an effort to provide employees with security for nonqualified deferred compensation, while still allowing deferral of income inclusion. A "rabbi trust" is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation, except that the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of insolvency or bankruptcy.

As discussed above, for purposes of section 83, property includes a beneficial interest in assets set aside from the claims of creditors, such as in a trust or fund, but does not include an unfunded and unsecured promise to pay money in the future. In the case of a rabbi trust, terms providing that the assets are subject to the claims of creditors of the employer in the case of insolvency or bankruptcy have been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.[196] As a result, no amount is included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

The IRS has issued guidance setting forth model rabbi trust provisions.[197] Revenue Procedure 92-64 provides a safe harbor for taxpayers who adopt and maintain grantor trusts in

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[195] Secs. 404(a)(5), (b) and (d) and sec. 83(h).

[196] This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence the popular name "rabbi trust." Priv. Ltr. Rul. 8113107 (Dec. 31, 1980).

[197] Rev. Proc. 92-64, 1992-2 C.B. 422, modified in part by Notice 2000-56, 2000-2 C.B. 393.

connection with unfunded deferred compensation arrangements. The model trust language requires that the trust provide that all assets of the trust are subject to the claims of the general creditors of the company in the event of the company's insolvency or bankruptcy.

Since the concept of rabbi trusts was developed, arrangements have developed which attempt to protect the assets from creditors despite the terms of the trust. Arrangements also have developed which effectively allow deferred amounts to be available to participants, while still meeting the safe harbor requirements set forth by the IRS.

Description of Proposal

Under the proposal, amounts deferred under a nonqualified deferred compensation plan[198] are currently includible in income unless certain requirements are satisfied. Distributions from nonqualified deferred compensation arrangements can only be distributed upon separation from service, disability, death, a specified time, change in control, or financial hardship. The deferred compensation plan cannot permit the acceleration of the time of such payment by reason of any event. Separation from service distributions to disqualified individuals (as defined in section 280G) cannot be made earlier than six months after the date of separation from service.

Amounts payable upon the occurrence of an event are not treated as amounts payable at a specified time. For example, amounts payable when an individual attains age 65 are payable at a specified time, while amounts payable when an individual's child begins college are payable upon the occurrence of an event.

Disability is defined as under the Social Security Act. Under such definition, an individual is considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months.

Financial hardship is defined as severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse or the participant's or beneficiary's dependent (as defined in 152(a)); loss of the participant's or beneficiary's property due to casualty; or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary. The amount of the distribution must be limited to the amount needed to satisfy the hardship plus taxes. Distributions can not be allowed to the extent that the hardship may be relieved through reimbursement or compensation by insurance or otherwise, or by liquidation of the participant's assets (to the extent such liquidation would not itself cause financial hardship).

Under the proposal, change in control will be defined by the Secretary.

Initial deferrals must be required to be made no later than prior to the beginning of the taxable year that the compensation is earned. In the first year that an employee becomes eligible for participation in the plan, the election can be made within 30 days after the date that the

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[198] A plan includes an agreement or arrangement.

employee is initially eligible. Subsequent elections to delay the timing or form of payment can be permitted only if the subsequent election is made more than 12 months prior to the date of the scheduled distribution and provides additional deferral for a period of not less than 5 years. A participant cannot be allowed to make more than one subsequent election. No accelerations can be allowed.

If impermissible distributions or elections are made, or if the plan or arrangement is amended to allow for impermissible distributions or elections, amounts deferred are currently includible in income. If the requirements of the proposal are not satisfied, in addition to current income inclusion, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred. Interest imposed under the proposal is treated as interest on an underpayment of tax. Earnings on amounts deferred are also subject to the proposal.

Under the proposal, amounts deferred through an offshore trust are currently includible in income. In addition, amounts deferred under a nonqualified deferred compensation arrangement that provides that upon a change in the employer's financial health, assets will be restricted to the payment of deferred compensation would also be currently includible in income. The rule is violated upon the earlier of when the assets are so restricted or when the plan provides that assets will be restricted. Interest at the underpayment rate plus one percentage point is also imposed on the underpayments that would have occurred had the amounts deferred in an offshore trust or arrangement with financial trigger been includible in income for the taxable year such amounts were first set aside.

A nonqualified deferred compensation plan is any plan that provides for the deferral of compensation other than a qualified retirement plan.

Annual reporting to the IRS of amounts deferred is required under the proposal. Amounts deferred are required to be reported on an individual's Form W-2 for the year deferred even if the amount is not currently includible in income for that taxable year.

The proposal is not intended to preclude the application of other rules that would require earlier income inclusion. The proposal provides the Secretary of the Treasury authority to prescribe regulations as are necessary to carry out the proposal.

Effective Date

The proposal is effective for amounts deferred in taxable years beginning after December 31, 2003.

L. Minimum Holding Period for Foreign Tax Credit with respect to Withholding Taxes on Income other than Dividends

Present Law

In general, U.S. persons may credit foreign taxes against U.S. tax on foreign-source income. The amount of foreign tax credits that may be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. Separate limitations are applied to specific categories of income.

As a consequence of the foreign tax credit limitations of the Code, certain taxpayers are unable to utilize their creditable foreign taxes to reduce their U.S. tax liability. U.S. taxpayers that are tax-exempt receive no U.S. tax benefit for foreign taxes paid on income that they receive.

Present law denies a U.S. shareholder the foreign tax credits normally available with respect to a dividend from a corporation or a regulated investment company ("RIC") if the shareholder has not held the stock for more than 15 days (within a 30-day testing period) in the case of common stock or more than 45 days (within a 90-day testing period) in the case of preferred stock (sec. 901(k)). The disallowance applies both to foreign tax credits for foreign withholding taxes that are paid on the dividend where the dividend-paying stock is held for less than these holding periods, and to indirect foreign tax credits for taxes paid by a lower-tier foreign corporation or a RIC where any of the required stock in the chain of ownership is held for less than these holding periods. Periods during which a taxpayer is protected from risk of loss (e.g., by purchasing a put option or entering into a short sale with respect to the stock) generally are not counted toward the holding period requirement. In the case of a bona fide contract to sell stock, a special rule applies for purposes of indirect foreign tax credits. The disallowance does not apply to foreign tax credits with respect to certain dividends received by active dealers in securities. If a taxpayer is denied foreign tax credits because the applicable holding period is not satisfied, the taxpayer is entitled to a deduction for the foreign taxes for which the credit is disallowed.

Description of Proposal

The proposal expands the present-law disallowance of foreign tax credits to include credits for gross-basis foreign withholding taxes with respect to any item of income or gain from property if the taxpayer who receives the income or gain has not held the property for more than 15 days (within a 30-day testing period), exclusive of periods during which the taxpayer is protected from risk of loss. The proposal does not apply to foreign tax credits that are subject to the present-law disallowance with respect to dividends. The proposal also does not apply to certain income or gain that is received with respect to property held by active dealers. Rules similar to the present-law disallowance for foreign tax credits with respect to dividends apply to foreign tax credits that are subject to the proposal. In addition, the proposal authorizes the Treasury Department to issue regulations providing that the proposal does not apply in appropriate cases.

Effective Date

The provision is effective for amounts that are paid or accrued more than 30 days after the date of enactment.

M. Permit Private Sector Debt Collection Companies to Collect Tax Debts

Present Law

In fiscal years 1996 and 1997, the Congress earmarked $13 million for IRS to test the use of private debt collection companies. There were several constraints on this pilot project. First, because both IRS and OMB considered the collection of taxes to be an inherently governmental function, only government employees were permitted to collect the taxes. The private debt collection companies were utilized to assist the IRS in locating and contacting taxpayers, reminding them of their outstanding tax liability, and suggesting payment options. If the taxpayer agreed at that point to make a payment, the taxpayer was transferred from the private debt collection company to the IRS. Second, the private debt collection companies were paid a flat fee for services rendered; the amount that was ultimately collected by the IRS was not taken into account in the payment mechanism.

The pilot program was discontinued because of disappointing results. GAO reported[199] that IRS collected $3.1 million attributable to the private debt collection company efforts; expenses were also $3.1 million. In addition, there were lost opportunity costs of $17 million to the IRS because collection personnel were diverted from their usual collection responsibilities to work on the pilot.

The IRS has recently revised its extensive Request for Information concerning its possible use of private debt collection companies.[200]

In general, Federal agencies are permitted to enter into contracts with private debt collection companies for collection services to recover indebtedness owed to the United States.[201] That provision does not apply to the collection of debts under the Internal Revenue Code.[202]

Description of Proposal

The proposal permits the IRS to use private debt collection companies to locate and contact taxpayers owing outstanding tax liabilities and to arrange payment of those taxes by the taxpayers. Several steps are involved. First, the private debt collection company contacts the taxpayer by letter.[203] If the taxpayer's last known address is incorrect, the private debt collection

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[199] GAO/GGD-97-129R Issues Affecting IRS' Collection Pilot (July 18, 1997).

[200] TIRNO-03-H-0001 (February 14, 2003), at www.procurement.irs.treas.gov. The basic request for information is 104 pages, and there are 16 additional attachments.

[201] 31 U.S.C. 3718.

[202] 31 U.S.C. 3718(f).

[203] Several portions of the proposal require that the IRS disclose confidential taxpayer information to the private debt collection company. Section 6103(n) permits disclosure for "the

company searches for the correct address. The private debt collection company is not permitted to contact either individuals or employers to locate a taxpayer. Second, the private debt collection company telephones the taxpayer to request full payment.[204] If the taxpayer cannot pay in full immediately, the private debt collection company offers the taxpayer an installment agreement providing for full payment of the taxes over a period of up to three years. If the taxpayer is unable to pay the outstanding tax liability in full over a three-year period, the private debt collection company obtains financial information from the taxpayer and will provide this information to the IRS for further processing and action by the IRS.

The proposal specifies several procedural conditions under which the proposal would operate. First, provisions of the Fair Debt Collection Act apply to the private debt collection company.[205] Second, taxpayer protections that are statutorily applicable to the IRS are also made statutorily applicable to the private sector debt collection companies. Third, the private sector debt collection companies are required to inform taxpayers of the availability of assistance from the Taxpayer Advocate.

The proposal creates a revolving fund from the amounts collected by the private debt collection companies. The private debt collection companies are paid out of this fund. Their compensation would be "based upon a number of factors, including quality of service, taxpayer satisfaction, and case resolution, in addition to collection results."[206]

Effective Date

The proposal is effective after the date of enactment.

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providing of other services ... for purposes of tax administration." Accordingly, no amendment to 6103 is necessary to implement the proposal.

[204] It is anticipated that the private debt collection company will not accept payment directly; payments will be processed by IRS employees.

[205] This is present law.

[206] Treasury General Explanations, p. 99.

N. Repeal the exclusion for foreign earned income and the exclusion or deduction for housing expenses

Present Law

U.S. citizens generally are subject to U.S. income tax on all their income, whether derived in the United States or elsewhere. A U.S. citizen who earns income in a foreign country also may be taxed on such income by that foreign country. However, the United States generally cedes the primary right to tax income derived by a U.S. citizen from sources outside the United States to the foreign country where such income is derived. Accordingly, a credit against the U.S. income tax imposed on foreign source taxable income is provided for foreign taxes paid on that income.

U.S. citizens living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign housing costs. In order to qualify for these exclusions, a U.S. citizen must be either: (1) a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year; or (2) present overseas for 330 days out of any 12-consecutive-month period. In addition, the taxpayer must have his or her tax home in a foreign country.

The exclusion for foreign earned income generally applies to income earned from sources outside the United States as compensation for personal services actually rendered by the taxpayer. The maximum exclusion for foreign earned income for a taxable year is $80,000 (for 2002 and thereafter). For taxable years beginning after 2007, the maximum exclusion amount is indexed for inflation.

The exclusion for housing costs applies to reasonable expenses, other than deductible interest and taxes, paid or incurred by or on behalf of the taxpayer for housing for the taxpayer and his or her spouse and dependents in a foreign country. The exclusion amount for housing costs for a taxable year is equal to the excess of such housing costs for the taxable year over an amount computed pursuant to a specified formula. In the case of housing costs that are not paid or reimbursed by the taxpayer's employer, the amount that would be excludible is treated instead as a deduction.

The combined earned income exclusion and housing cost exclusion may not exceed the taxpayer's total foreign earned income. The taxpayer's foreign tax credit is reduced by the amount of such credit that is attributable to excluded income.

Special exclusions apply in the case of taxpayers who reside in one of the U.S. possessions.

Description of the Proposal

The proposal repeals the exclusion for foreign earned income and the exclusion or deduction for housing expenses.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2004.

O. Modify Qualification Rules for Tax-Exempt Property and Casualty Insurance Companies

Present Law

A property and casualty insurance company is eligible to be exempt from Federal income tax if its net written premiums or direct written premiums (whichever is greater) for the taxable year do not exceed $350,000 (sec. 501(c)(15)).

A property and casualty insurance company may elect to be taxed only on taxable investment income if its net written premiums or direct written premiums (which ever greater) for the taxable year exceed $350,000, but do not exceed $1.2 million (sec. 831(b)).

For purposes of determining the amount of company's net written premiums or direct written premiums under these rules, premiums received by all members of a controlled group of corporations of which the company is a part are taken into account. For this purpose, a more-than-50-percent threshhold applies under the vote and value requirements with respect to stock ownership for determining a controlled group, and rules treating a life insurance company as part of a separate controlled group or as an excluded member of a group do not apply (secs. 501(c)(15), 831(b)(2)(B) and 1563).

Description of Proposal

The proposal modifies the requirements for a property and casualty insurance company to be eligible for tax-exempt status, and to elect to be taxed only on taxable investment income.

Under the proposal, a property and casualty insurance company is eligible to be exempt from Federal income tax if (a) its gross receipts for the taxable year do not exceed $600,000, and (b) the premiums received for the taxable year are greater than 50 percent of the gross receipts. For purposes of determining gross receipts, the gross receipts of all members of a controlled group of corporations of which the company is a part are taken into account.

The proposal also provides that a property and casualty insurance company may elect to be taxed only on taxable investment income if its net written premiums or direct written premiums (whichever is greater) do not exceed $1.2 million (without regard to whether such premiums exceed $350,000). The proposal retains the present-law rule that, for purposes of determining the amount of company's net written premiums or direct written premiums under this rule, premiums received by all members of a controlled group of corporations of which the company is a part are taken into account.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2003.

P. Authorize IRS to Enter into Installment Agreements that Provide for Partial Payment

Present Law

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed (sec. 6159). An installment agreement does not reduce the amount of taxes, interest, or penalties owed. Generally, during the period installment payments are being made, other IRS enforcement actions (such as levies or seizures) with respect to the taxes included in that agreement are held in abeyance.

Prior to 1998, the IRS administratively entered into installment agreements that provided for partial payment (rather than full payment) of the total amount owed over the period of the agreement. In that year, the IRS Chief Counsel issued a memorandum concluding that partial payment installment agreements were not permitted.

Description of Proposal

The proposal clarifies that the IRS is authorized to enter into installment agreements with taxpayers which do not provide for full payment of the taxpayer's liability over the life of the agreement. The proposal also requires the IRS to review partial payment installment agreements at least every two years. The primary purpose of this review is to determine whether the financial condition of the taxpayer has significantly changed so as to warrant an increase in the value of the payments being made.

Effective Date

The proposal is effective for installment agreements entered into on or after the date of enactment.

Q. Denial of Deduction for Certain Fines, Penalties, and Other Amounts

Present Law

Under present law, no deduction is allowed as a trade or business expense under section 162(a) for the payment of a fine or similar penalty to a government for the violation of any law (sec. 162(f)). The enactment of section 162(f) in 1969 codified existing case law that denied the deductibility of fines as ordinary and necessary business expenses on the grounds that "allowance of the deduction would frustrate sharply defined national or State policies proscribing the particular types of conduct evidenced by some governmental declaration thereof."[207]

Treasury regulation section 1.162-21(b)(1) provides that a fine or similar penalty includes an amount: (1) paid pursuant to conviction or a plea of guilty or *nolo contendere* for a crime (felony or misdemeanor) in a criminal proceeding; (2) paid as a civil penalty imposed by Federal, State, or local law, including additions to tax and additional amounts and assessable penalties imposed by chapter 68 of the Code; (3) paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal); or (4) forfeited as collateral posted in connection with a proceeding which could result in imposition of such a fine or penalty. Treasury regulation section 1.162-21(b)(2) provides, among other things, that compensatory damages (including damages under section 4A of the Clayton Act (15 U.S.C. 15a), as amended) paid to a government do not constitute a fine or penalty.

Description of Proposal

The proposal modifies the rules regarding the determination whether payments are nondeductible payments of fines or penalties under section 162(f). In particular, the proposal generally provides that amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government in relation to the violation of any law or the investigation or inquiry into the potential violation of any law are nondeductible under any provision of the income tax provisions.[208] The proposal applies to deny a deduction for any such payments, including those where there is no admission of guilt or liability and those made for the purpose of avoiding further investigation or litigation. An exception applies to payments that the taxpayer establishes are restitution.[209]

It is intended that a payment will be treated as restitution only if the payment is required to be paid to the specific persons, or in relation to the specific property, actually harmed by the conduct of the taxpayer that resulted in the payment. Thus, a payment to or with respect to a

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[207] S. Rep. 91-552, 91st Cong, 1st Sess., 273-74 (1969), referring to *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30 (1958).

[208] The proposal provides that such amounts are nondeductible under chapter 1 of the Internal Revenue Code.

[209] The proposal does not affect the treatment of antitrust payments made under section 4 of the Clayton Act, which will continue to be governed by the provisions of section 162(g).

class broader than the specific persons or property that were actually harmed (e.g., to a class including similarly situated persons or property) does not qualify as restitution.[210] Restitution is limited to the amount that bears a substantial quantitative relationship to the harm caused by the past conduct or actions of the taxpayer that resulted in the payment in question. If the party harmed is a government or other entity, then restitution includes payment to such harmed government or entity, provided the payment bears a substantial quantitative relationship to the harm. However, restitution does not include reimbursement of government investigative or litigation costs, or payments to whistleblowers.

Amounts paid or incurred to, or at the direction of, any self-regulatory entity that regulates a financial market or other market that is a qualified board or exchange under section 1256(g)(7), and that is authorized to impose sanctions (e.g., the National Association of Securities Dealers) are subject to the proposal. To the extent provided in regulations, amounts paid or incurred to, or at the direction of, any other nongovernmental entity that exercises self-regulatory powers as part of performing an essential governmental function are also subject to the provision.

No inference is intended as to the treatment of payments as nondeductible fines or penalties under present law. In particular, the bill is not intended to limit the scope of present-law section 162(f) or the regulations thereunder.

Effective Date

The proposal is effective for amounts paid or incurred on or after April 28, 2003; however the proposal does not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Any order or agreement requiring court approval is not a binding order or agreement for this purpose unless such approval was obtained on or before April 27, 2003.

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[210] Similarly, a payment to a charitable organization benefitting a broader class than the persons or property actually harmed, or to be paid out without a substantial quantitative relationship to the harm caused, would not qualify as restitution. Under the proposal, such a payment not deductible under section 162 would also not be deductible under section 170.

R. Deposits Made to Suspend the Running of Interest on Potential Underpayments

Present Law

Generally, interest on underpayments and overpayments continues to accrue during the period that a taxpayer and the IRS dispute a liability. The accrual of interest on an underpayment is suspended if the IRS fails to notify an individual taxpayer in a timely manner, but interest will begin to accrue once the taxpayer is properly notified. No similar suspension is available for other taxpayers.

A taxpayer that wants to limit its exposure to underpayment interest has a limited number of options. The taxpayer can continue to dispute the amount owed and risk paying a significant amount of interest. If the taxpayer continues to dispute the amount and ultimately loses, the taxpayer will be required to pay interest on the underpayment from the original due date of the return until the date of payment.

In order to avoid the accrual of underpayment interest, the taxpayer may choose to pay the disputed amount and immediately file a claim for refund. Payment of the disputed amount will prevent further interest from accruing if the taxpayer loses (since there is no longer any underpayment) and the taxpayer will earn interest on the resultant overpayment if the taxpayer wins. However, the taxpayer will generally lose access to the Tax Court if it follows this alternative. Amounts paid generally cannot be recovered by the taxpayer on demand, but must await final determination of the taxpayer's liability. Even if an overpayment is ultimately determined, overpaid amounts may not be refunded if they are eligible to be offset against other liabilities of the taxpayer.

The taxpayer may also make a deposit in the nature of a cash bond. The procedures for making a deposit in the nature of a cash bond are provided in Rev. Proc. 84-58.

A deposit in the nature of a cash bond will stop the running of interest on an amount of underpayment equal to the deposit, but the deposit does not itself earn interest. A deposit in the nature of a cash bond is not a payment of tax and is not subject to a claim for credit or refund. A deposit in the nature of a cash bond may be made for all or part of the disputed liability and generally may be recovered by the taxpayer prior to a final determination. However, a deposit in the nature of a cash bond need not be refunded to the extent the Secretary determines that the assessment or collection of the tax determined would be in jeopardy, or that the deposit should be applied against another liability of the taxpayer in the same manner as an overpayment of tax. If the taxpayer recovers the deposit prior to final determination and a deficiency is later determined, the taxpayer will not receive credit for the period in which the funds were held as a deposit. The taxable year to which the deposit in the nature of a cash bond relates must be designated, but the taxpayer may request that the deposit be applied to a different year under certain circumstances.

Description of Proposal

In general

The proposal allows a taxpayer to deposit cash with the IRS that the may subsequently be used to pay an underpayment of income, gift, estate, generation-skipping, or certain excise taxes. Interest will not be charged on the portion of the underpayment that is paid by the deposited amount for the period the amount is on deposit. Generally, deposited amounts that have not been used to pay a tax may be withdrawn at any time if the taxpayer so requests in writing. The withdrawn amounts will earn interest at the applicable Federal rate to the extent they are attributable to a disputable tax.

The Secretary may issue rules relating to the making, use, and return of the deposits.

Use of a deposit to offset underpayments of tax

Any amount on deposit may be used to pay an underpayment of tax that is ultimately assessed. If an underpayment is paid in this manner, the taxpayer will not be charged underpayment interest on the portion of the underpayment that is so paid for the period the funds were on deposit.

For example, assume a calendar year individual taxpayer deposits $20,000 on May 15, 2005, with respect to a disputable item on its 2004 income tax return. On April 15, 2007, an examination of the taxpayer's year 2004 income tax return is completed, and the taxpayer and the IRS agree that the taxable year 2004 taxes were underpaid by $25,000. The $20,000 on deposit is used to pay $20,000 of the underpayment, and the taxpayer also pays the remaining $5,000. In this case, the taxpayer will owe underpayment interest from April 15, 2005 (the original due date of the return) to the date of payment (April 15, 2007) only with respect to the $5,000 of the underpayment that is not paid by the deposit. The taxpayer will owe underpayment interest on the remaining $20,000 of the underpayment only from April 15, 2005, to May 15, 2005, the date the $20,000 was deposited.

Withdrawal of amounts

A taxpayer may request the withdrawal of any amount of deposit at any time. The Secretary must comply with the withdrawal request unless the amount has already been used to pay tax or the Secretary properly determines that collection of tax is in jeopardy. Interest will be paid on deposited amounts that are withdrawn at a rate equal to the short-term applicable Federal rate for the period from the date of deposit to a date not more than 30 days preceding the date of the check paying the withdrawal. Interest is not payable to the extent the deposit was not attributable to a disputable tax.

For example, assume a calendar year individual taxpayer receives a 30-day letter showing a deficiency of $20,000 for taxable year 2004 and deposits $20,000 on May 15, 2006. On April 15, 2007, an administrative appeal is completed, and the taxpayer and the IRS agree that the 2004 taxes were underpaid by $15,000. $15,000 of the deposit is used to pay the underpayment. In this case, the taxpayer will owe underpayment interest from April 15, 2005 (the original due date of the return) to May 15, 2006, the date the $20,000 was deposited. Simultaneously with the use of the $15,000 to offset the underpayment, the taxpayer requests the return of the remaining amount of the deposit (after reduction for the underpayment interest owed by the taxpayer from April 15, 2005, to May 15, 2006). This amount must be returned to the taxpayer

with interest determined at the short-term applicable Federal rate from the May 15, 2006, to a date not more than 30 days preceding the date of the check repaying the deposit to the taxpayer.

Limitation on amounts for which interest may be allowed

Interest on a deposit that is returned to a taxpayer shall be allowed for any period only to the extent attributable to a disputable item for that period. A disputable item is any item for which the taxpayer 1) has a reasonable basis for the treatment used on its return and 2) reasonably believes that the Secretary also has a reasonable basis for disallowing the taxpayer's treatment of such item.

All items included in a 30-day letter to a taxpayer are deemed disputable for this purpose. Thus, once a 30-day letter has been issued, the disputable amount cannot be less than the amount of the deficiency shown in the 30-day letter. A 30-day letter is the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

Deposits are not payments of tax

A deposit is not a payment of tax prior to the time the deposited amount is used to pay a tax. Thus, the interest received on withdrawn deposits will not be eligible for the proposed exclusion from income of an individual. Similarly, withdrawal of a deposit will not establish a period for which interest was allowable at the short-term applicable Federal rate for the purpose of establishing a net zero interest rate on a similar amount of underpayment for the same period.

Effective Date

The proposal applies to deposits made after the date of enactment. Amounts already on deposit as of the date of enactment are treated as deposited (for purposes of applying this provision) on the date the taxpayer identifies the amount as a deposit made pursuant to this provision.

S. Clarification of Rules For Payment of Estimated Tax for Certain Deemed Asset Sales

Present Law

In certain circumstances, taxpayers can make an election under section 338(h)(10) to treat a qualifying purchase of 80 percent of the stock of a target corporation by a corporation from a corporation that is a member of an affiliated group (or a qualifying purchase of 80 percent of the stock of an S corporation by a corporation from S corporation shareholders) as a sale of the assets of the target corporation, rather than as a stock sale. The election must be made jointly by the buyer and seller of the stock and is due by the 15th day of the ninth month beginning after the month in which the acquisition date occurs. An agreement for the purchase and sale of stock often may contain an agreement of the parties to make a section 338(h)(10) election.

Section 338(a) also permits a unilateral election by a buyer corporation to treat a qualified stock purchase of a corporation as a deemed asset acquisition, whether or not the seller of the stock is a corporation (or an S corporation is the target). In such a case, the seller or sellers recognize gain or loss on the stock sale (including any estimated taxes with respect to the stock sale), and the target corporation recognizes gain or loss on the deemed asset sale.

Section 338(h)(13) provides that, for purposes of section 6655 (relating to additions to tax for failure by a corporation to pay estimated income tax), tax attributable to a deemed asset sale under section 338(a)(1) shall not be taken into account. Some taxpayers may be taking the position that this exception applies to a section 338(h)(10) election and that when such an election is made, neither any stock sale nor any asset sale needs to be taken into account for estimated tax purposes.

Description of Proposal

The proposal would clarify section 338(h)(13) to provide that the exception for estimated tax purposes with respect to tax attributable to a deemed asset sale does not apply with respect to a qualified stock purchase for which an election is made under section 338(h)(10).

Under the proposal, if a transaction eligible for the election under section 338(h)(10) occurs, estimated tax would be determined based on the stock sale unless and until there is an agreement of the parties to make a section 338(h)(10) election.

If at the time of the sale there is an agreement of the parties to make a section 338(h)(10) election, then estimated tax would be computed based on an asset sale. If the agreement to make a section 338(h)(10) election is concluded after the stock sale, such that the original computation was based on a stock sale, estimated tax would be recomputed based on the asset sale election.

No inference is intended as to present law.

Effective Date

The proposal would be effective for transactions that occur after the date of enactment of the proposal.

T. Limit Deduction for Charitable Contributions of Patents and Similar Property

Present Law

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization.[211] The amount of deduction generally equals the fair market value of the contributed cash or property on the date of the contribution.

For certain contributions of property, the taxpayer is required to reduce the deduction amount by any gain, generally resulting in a deduction equal to the taxpayer's basis. This rule applies to contributions of: (1) property that, at the time of contribution, would have resulted in short-term capital gain if the property was sold by the taxpayer on the contribution date; (2) tangible personal property that is used by the donee in a manner unrelated to the donee's exempt (or governmental) purpose; and (3) property to or for the use of a private foundation (other than a foundation defined in section 170(b)(1)(E)).

Charitable contributions of capital gain property generally are deductible at fair market value. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property are subject to different percentage limitations than other contributions of property.

Description of Proposal

The proposal provides that the amount of the deduction for charitable contributions of patents or similar property (for example, patent applications, copyrights, trade names, trade secrets, trademarks) is limited to the lesser of the taxpayer's basis in the contributed property or the fair market value of the contributed property (determined at the time of the contribution). The proposal applies to direct transfers of a patent or similar property to a qualified charity and to indirect transfers or other arrangements that are intended to disguise the contribution of a patent as a contribution of other property or otherwise to circumvent the rule of the proposal.

Effective Date

The proposal would be effective for contributions of patents and similar property made after May 7, 2003.

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[211] Charitable deductions are provided for income, estate, and gift tax purposes. Secs. 170, 2055, and 2522, respectively.

U. Temporary State Fiscal Relief Fund

Description of Proposal

The proposal establishes a fund to provide $20 billion, equally divided among State and local governments, to be used for education or job training; health care services, including Medicaid; transportation or other infrastructure; law enforcement or public safety; and other essential government services.

V. Extension of Customs User Fees

Present Law

The Border and Transportation Security Directorate of the Department of Homeland Security collect nine different conveyance and passenger user fees and a merchandise processing fee. All of these fees expire after September 30, 2003.

Description of Proposal

The proposal extends the conveyance and passenger user fees and merchandise processing fee through December 31, 2013.

Effective Date

The proposal is effective on the date of enactment.

W. SSI Redetermination

Description of Proposal

This offset would align the initial review requirements for Title XVI with those currently required under Title II. As under Title II, the Commissioner of Social Security would be required to review initial Title XVI SSI blindness and disability determinations made by agencies in advance of awarding payments.

For FY 2004, the SSI review would be required for 25 percent of all State-determined allowances. In FY 2005 and thereafter, review would be required for at least 50 percent of state-determined allowances. To the extent feasible, this offset would require that the Commissioner select for review the determinations most likely to be incorrect.

X. Covering Childless Adults with SCHIP Funds

Present Law

In 1997, when the State Children Health Insurance Program ("SCHIP") was created, Congress specified that SCHIP allocations only could be used, "to enable [States] to initiate and expand the provision of child health assistance to uninsured, low-income children in an effective and efficient manner." The use of funds dedicated by Congress to low-income uninsured children on childless adults is an inappropriate implementation of the SCHIP statute.

Description of Proposal

In the past, the Secretary of Health and Human Services has approved waivers that spend SCHIP dollars to cover childless adults. The proposal clarifies the intent of Congress; specifically stating that SCHIP funds cannot be spent on childless adults. It will no longer be legal for the Secretary to approve a waiver providing health insurance coverage through SCHIP to childless adults.

JOINT COMMITTEE ON TAXATION
May 8, 2003
JCX-45-03

ESTIMATED REVENUE EFFECTS OF A CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO THE "JOBS AND GROWTH TAX ACT OF 2003," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON MAY 8, 2003

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
Acceleration of Certain Previously Enacted Tax Reductions and Increased Expensing for Small Businesses														
1. Accelerate the expansion of the 10% bracket	tyba 12/31/02	-1,549	-8,445	-6,596	-6,909	-7,385	-4,973	-3,931	-3,859	-1,145	---	---	-35,857	-44,792
2. Accelerate the 2006 rate schedule	tyba 12/31/02	-9,531	-38,809	-19,811	-5,864	---	---	---	---	---	---	---	-74,015	-74,015
3. Accelerate the expansion of the 15% individual income tax rate bracket and the increase in the standard deduction for married taxpayers filing joint returns	tyba 12/31/02	-4,936	-24,904	-11,045	-5,577	-3,041	-1,519	-335	---	---	---	---	-51,022	-51,357
4. Accelerate child credit increase to $1,000	tyba 12/31/02	-13,711	-5,820	-15,468	-12,525	-12,372	-12,267	-11,314	-6,336	---	---	---	-72,163	-89,813
5. Increase section 179 expensing - increase the amount that can be expensed from $25,000 to $75,000 and increase the phaseout threshold amount from $200,000 to $325,000; include software in section 179 property; and index both the deduction limit and the phaseout threshold after 2003 (sunset after 2012)	tyba 12/31/02	-1,399	-2,658	-3,056	-3,466	-3,090	-2,782	-2,593	-2,490	-2,429	-2,392	2,961	-16,451	-23,393
6. Increase individual AMT exemption amount by $6,000 single and $12,000 joint for 2003 and 2004, maintain level for 2005	tyba 12/31/02	-1,393	-12,231	-18,682	-16,962	---	---	---	---	---	---	---	-49,268	-49,268
Total of Acceleration of Certain Previously Enacted Tax Reductions and Increased Expensing for Small Businesses		-32,519	-92,867	-74,658	-51,303	-25,888	-21,541	-18,173	-12,685	-3,574	-2,392	2,961	-298,776	-332,638
Exclude qualified dividends from taxable income phased-in as follows: 100 percent of the first $500 per return and 10 percent from 2004 through 2007, 20 percent in 2008 through 2012 for amounts exceeding $500 (sunset on 12/31/12) [1]	**dri tyba 12/31/03**	---	-2,034	-4,382	-5,289	-5,665	-6,950	-10,294	-10,981	-11,985	-13,097	-9,830	-24,320	-80,507
Revenue Offset Provisions														
A. Provisions to Curtail Tax Shelters Previously Approved by the Committee on Finance														
1. Clarification of the economic substance doctrine and related penalty provisions	ta DOE	347	997	1,234	1,157	1,042	1,079	1,193	1,328	1,510	1,722	1,963	5,856	13,572
2. Provisions relating to reportable transactions and tax shelters	various dates after DOE [2]	35	92	115	119	120	124	131	139	150	164	179	604	1,366
3. Modification to the substantial understatement penalty	tyba DOE	---	---	4	11	19	23	26	30	34	38	38	57	223

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
4. Actions to enjoin conduct with respect to tax shelters	DOE	*Negligible Revenue Effect*												
5. Understatement of taxpayer's liability by income tax return preparer	dpa DOE	*Negligible Revenue Effect*												
6. Impose a civil penalty (of up to $5,000) on failure to report interest in foreign financial accounts	DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	1	3
7. Frivolous tax submissions	[4]	1	3	3	3	3	3	3	3	3	3	3	16	31
8. Amend Code section 6501 to provide for 6-year statute of limitations for undisclosed listed transactions	tyba DOE	---	---	---	1	1	1	1	1	1	1	1	3	8
9. Amend Code section 163 to disallow a deduction for deficiency interest paid to the IRS on underpayments involving tax motivated transactions	tyba DOE	---	---	---	1	1	3	4	4	4	4	4	5	25
B. Enron-Related Tax Shelter Provisions														
1. Limitation on transfer or importation of built-in losses	ta 2/13/03	19	112	123	136	149	164	180	198	218	240	264	703	1,803
2. No reduction of basis under section 734 in stock held by partnership in corporate partner	da 2/13/03	2	7	13	20	28	36	44	51	54	56	57	105	368
3. Repeal of special rules for FASITs	after 2/13/03	*Negligible Revenue Effect*												
4. Expanded disallowance of deduction for interest on convertible debt	diia 2/13/03	5	87	89	91	94	96	98	101	103	106	109	462	979
5. Expanded authority to disallow tax benefits under section 269	after 2/13/03	2	8	9	9	10	10	11	11	12	12	13	48	108
6. Modifications of certain rules relating to controlled foreign corporations	[5]	5	20	15	8	4	5	6	8	10	12	15	57	108
C. Other Provisions Previously Approved by the Committee on Finance														
1. Affirmation of consolidated return regulation authority	[6]	*Negligible Revenue Effect*												
2. Require CEO signatures on income tax returns	rfa DOE	*Negligible Revenue Effect*												
3. Impose mark-to-market on individuals who expatriate	[7]	3	98	84	80	74	71	67	61	57	54	51	410	700
4. Extension of IRS User Fees (through 9/30/13) [8]	rma DOE	---	33	34	35	36	38	39	41	42	44	45	176	386
5. Provisions to Discourage Corporate Expatriation:														
a. Tax treatment of inversion transactions	[9]	34	159	117	140	168	202	242	290	348	418	493	820	2,611
b. Excise tax on stock compensation of insiders in inverted corporations	generally 7/11/02	21	14	10	10	10	10	10	10	10	10	10	75	125
c. Reinsurance agreements	rra 4/11/02	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	2	5
6. Add Hepatitis A to the list of taxable vaccines	[10]	3	8	9	9	9	9	9	9	9	9	9	45	91
D. Other Revenue Raising Provisions														
1. Disallowance of partnership loss transfers	DOE	2	18	39	57	70	79	84	86	89	91	94	266	710
2. Treatment of stripped interest in bond and preferred stock funds	pada DOE	1	11	8	3	[3]	[3]	[3]	[3]	[3]	[3]	[3]	24	25
3. Reporting of taxable mergers and acquisitions	aa DOE	[3]	1	2	3	3	3	3	3	3	3	3	12	27
4. Deferred compensation reforms	tyba 12/31/03	---	192	229	114	36	20	18	17	101	129	115	591	971
5. Minimum holding period for foreign tax credit on withholding tax on income other than dividends	apoamt30da DOE	[3]	1	3	3	3	3	3	4	4	4	4	13	32
6. Permit private sector debt collection companies to collect tax debts	DOE	---	---	70	129	131	116	106	106	106	106	106	445	973
7. Repeal exclusion under section 911	1/1/05	---	---	714	3,076	3,192	3,361	3,592	3,887	4,257	4,721	5,297	10,343	32,097

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
8. Reform of 501(c)(15) to apply to organizations with gross receipts of $600,000 and premiums at least 50% of gross receipts	tyba 12/31/03	---	48	105	118	124	129	134	139	145	151	157	523	1,249
9. Authorize IRS to enter into installment agreements that provide for partial payment, require 2-year review	iaeio/a DOE	8	40	14	5	[3]	[3]	[3]	[3]	[3]	[3]	[3]	61	63
10. Deductibility of fines and penalties	apoia 4/27/03	24	76	10	10	10	10	10	10	10	10	10	141	191
11. Deposits to stop the running of interest on potential underpayments	dma DOE	13	144	-5	-6	-6	-6	-6	-7	-7	-7	-7	134	101
12. Require estimated taxes to be paid based upon a deemed asset sale if there is an agreement to make a section 338(h)(10) election	toa DOE	39	56	13	3	3	3	4	4	4	4	5	117	138
13. Limit donor deductions for a contribution of a patent or similar intellectual property to an organization described in section 170(c) to the donor's basis	dofca	96	271	356	366	377	389	400	412	425	438	451	1,855	3,981
Total of Revenue Offset Provisions		**660**	**2,496**	**3,417**	**5,711**	**5,711**	**5,981**	**6,412**	**6,946**	**7,702**	**8,543**	**9,489**	**23,970**	**63,070**
State Aid Trust Fund [11]	---	**-14,000**	**-6,000**	---	---	---	---	---	---	---	---	---	**-20,000**	**-20,000**
Customs User Fees Extension														
1. Extend passenger and conveyance processing fee through 12/31/13 [12]	DOE	---	229	314	329	346	363	381	400	420	441	464	1,581	3,687
2. Extend merchandise processing fee through 12/31/13 [12]	DOE	---	1,089	1,151	1,216	1,286	1,359	1,436	1,518	1,605	1,696	1,793	6,101	14,149
Total of Customs User Fees Extension		---	**1,318**	**1,465**	**1,545**	**1,632**	**1,722**	**1,817**	**1,918**	**2,025**	**2,137**	**2,257**	**7,682**	**17,836**
SSI Reform [11]	---	---	---	**6**	**24**	**51**	**81**	**115**	**150**	**186**	**227**	**256**	**303**	**277**	**1,399**
SCHIP Provision [11]	---	---	---	**35**	**45**	**60**	**75**	**85**	**95**	**95**	**105**	**100**	**105**	**300**	**800**
NET TOTAL [13] [14]		**-45,859**	**-97,046**	**-74,089**	**-49,225**	**-24,054**	**-20,588**	**-19,993**	**-14,521**	**-5,500**	**-4,453**	**5,285**	**-310,867**	**-350,040**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

aa = acquisitions after
apoamt30da = amounts paid or accrued more than 30 days after
apoia = amounts paid or incurred after
da = distributions after
diia = debt instrument issued after
DOE = date of enactment
dofca = date of first committee action
dma = distributions made after
dpa = documents prepared after
dri = dividends received in
iaeio/a = installment agreements entered into on or after
o/a = on or after
pada = purchases and dispositions after
rfa = returns filed after
rma = requests made after
rra = risk reinsured after
ta = transactions after
toa = transactions occurring after
tyba = taxable years beginning after

[Footnotes for JCX-45-03 appear on the following page]

Footnotes for JCX-45-03:

[1] These estimates assume that any dividend from a foreign corporation or any dividend described in Internal Revenue Code section 404(k) would be taxed at ordinary rates. RIC and REIT shareholders receive tax relief to the extent that dividends paid by the RIC or REIT are qualified dividends received by the RIC or REIT. Also, we have assumed that the proposal would exclude qualified dividends from investment income for the purpose of Internal Revenue Code Section 163(d). We have assumed that certain anti-abuse rules, including the imposition of a 45-day holding period, would be adopted. The amount of the exclusion would be included in adjusted gross income.

[2] Effective dates for provisions relating to reportable transactions and tax shelters: the penalty for failure to disclose reportable transactions is effective for returns and statements the due date of which is after the date of enactment; the modification to the accuracy-related penalty for listed or reportable transactions is effective for taxable years ending after the date of enactment; the tax shelter exception to confidentiality privileges is effective for communications made on or after the date of enactment; the material advisor and investor list disclosure provisions applies to transactions with respect to which material aid, assistance or advice is provided after the date of enactment; the failure to register tax shelter penalty applies to returns the due date for which is after the date of enactment; the investor list penalty applies to requests made after the date of enactment; and the penalty on promoters of tax shelters is effective for activities after the date of enactment.

[3] Gain of less than $1 million.

[4] Effective for submissions made and issues raised after the first list is prescribed under section 6702(c).

[5] Effective for taxable years of controlled foreign corporation beginning after February 13, 2003, and to taxable years of U.S. shareholders in which or with which such taxable years of controlled corporation end.

[6] Effective for all taxable years, whether beginning before, with, or after the date of enactment.

[7] Generally effective for U.S. citizens who expatriate or long-term residents who terminate their residency on or after February 5, 2003.

[8] Estimate provided by the Congressional Budget Office.

[9] Effective for certain transactions completed after March 20, 2002, and would also affect certain taxpayers who completed transactions before March 21, 2002.

[10] Effective for vaccines sold beginning on the first day of the first month beginning more than four weeks after the date of enactment.

[11] Estimate provided by the Congressional Budget Office.

[12] Estimate provided by the Congressional Budget Office. Amounts shown represent offsetting receipts.

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
[13] Includes the following outlay effects	4,381	1,110	4,595	4,175	3,842	3,707	3,520	2,200	124	2	1	21,810	27,657

[14] Returns with AMT liability (millions):

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Present law	2.2	3.7	9.7	14.9	19.2	23.8	26.8	30.0	14.2	17.3	20.3
Change due to proposal	-0.3	-1.4	-6.7	3.6	2.2	0.6	0.5	0.5	---	---	---

Joint Committee on Taxation
May 8, 2003
JCX-46-03

DESCRIPTION OF ADDITIONAL CHAIRMAN'S MODIFICATIONS TO THE PROVISIONS OF THE "JOBS AND GROWTH TAX ACT OF 2003"

The following additional modifications are made to the provisions of the Jobs and Growth Act of 2003.

I. ADDITIONAL MODIFICATIONS TO THE JOBS AND GROWTH ACT OF 2003

A. Partial Exclusion of Dividend Income from Tax

The exclusion for dividends provided in the Chairman's Modification also includes dividends paid by a foreign corporation, other than other than a foreign corporation whose stock is not regularly traded on an established securities market, a foreign investment company, a passive foreign investment company, or a foreign personal holding company.

B. Temporary State Fiscal Relief Fund

The Chairman's Modification establishes a fund to provide $20 billion, equally divided among State and local governments, to be used for education or job training; health care services, including Medicaid; transportation or other infrastructure; law enforcement or public safety; and other essential government services. The purposes of the fund could include additional measures to ensure that fiduciary attorney fee standards are adequately respected.

II. NEW PROVISIONS

A. Extension of Provision Permitting Qualified Transfers of Excess Pension Assets to Retiree Health Accounts

Present Law

A qualified transfer of excess assets of a defined benefit plan may be made to a separate account within the plan in order to fund retiree health benefits.[1] Excess assets generally means the excess, if any, of the value of the plan's assets[2] over the greater of (1) the lesser of (a) the

[1] Sec. 420.

[2] The value of plan assets is the lesser of fair market value or actuarial value.

accrued liability under the plan (including normal cost) or (b) 170 percent of the plan's current liability (for 2003),[3] or (2) 125 percent of the plan's current liability.

Excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. Amounts transferred in a qualified transfer are not includible in the gross income of the employer and are not subject to the excise tax on reversions of assets in a defined benefit plan. No deduction is allowed to the employer for (1) a qualified transfer or (2) the payment of qualified current retiree health liabilities out of transferred funds (and any income thereon).

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer (or in the case of a participant who separated in the one-year period ending on the date of the transfer, immediately before the separation). In addition, at least 60 days before the date of a qualified transfer, the plan administrator must notify each participant and beneficiary under the plan of such transfer.[4] The notice must include information with respect to the amount of excess pension assets, the portion to be transferred, the amount of health benefits liabilities expected to be provided with the assets transferred, and the amount of pension benefits of the participant that will be vested immediately after the transfer. The employer maintaining the plan must also provide advance notice of the transfer to the Department of Labor and the Department of Treasury, and any employee organization representing participants in the plan. A copy of this notice must be available for inspection in the principal office of the administrator.

No qualified transfer may be made after December 31, 2005.

Description of Proposal

The proposal allows qualified transfers of excess defined benefit plan assets through December 31, 2013.

Effective Date

The proposal is effective for transfers made in taxable years beginning after December 31, 2005.

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[3] The current liability full funding limit is repealed for years beginning after 2003. Under the general sunset provision of EGTRRA, the limit is reinstated for years after 2010.

[4] ERISA sec. 101(e).

B. Proration Rules For Life Insurance Business of Property And Casualty Insurance Companies

Present Law

Life insurance company proration rules

A life insurance company is subject to tax on its life insurance company taxable income (LICTI) (sec. 801). LICTI is life insurance gross income reduced by life insurance deductions. For this purpose, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves. Because deductible reserve increases might be viewed as being funded proportionately out of taxable and tax-exempt income, the net increase and net decrease in reserves are computed by reducing the ending balance of the reserve items by the policyholders' share of tax-exempt interest (secs. 805(a)(4), 812). Similarly, a life insurance company is allowed a dividends-received deduction for intercorporate dividends from nonaffiliates only in proportion to the company's share of such dividends. Fully deductible dividends from affiliates are excluded from the application of this proration formula, if such dividends are not themselves distributions from tax-exempt interest or from dividend income that would not be fully deductible if received directly by the taxpayer. In addition, the proration rule includes in prorated amounts the increase for the taxable year in policy cash values of life insurance policies and annuity and endowment contracts.

Property and casualty insurance company proration rules

The taxable income of a property and casualty insurance company is determined as the sum of its underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions (sec. 832). Underwriting income means premiums earned during the taxable year less losses incurred and expenses incurred. In calculating its reserve for losses incurred, a property and casualty insurance company must reduce the amount of losses incurred by 15 percent of (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase for the taxable year in the cash value of life insurance, endowment or annuity contracts (sec. 832(b)(5)(B)).

This 15-percent proration requirement was enacted in 1986. The reason the provision was adopted was Congress' belief that "it is not appropriate to fund loss reserves on a fully deductible basis out of income which may be, in whole or in part, exempt from tax. The amount of the reserves that is deductible should be reduced by a portion of such tax-exempt income to reflect the fact that reserves are generally funded in part from tax-exempt interest or from wholly or partially deductible dividends."[5]

[5] H. R. Rep. No. 99-426, Report of the Committee on Ways and Means on H.R. 3838, The Tax Reform Act of 1985 (99th Cong., 1st Sess.,), 670.

Property and casualty insurance companies with life insurance reserves

Present law provides that a life insurance company means an insurance company engaged in the business of issuing life insurance, annuity, or noncancellable accident and health insurance, provided its reserves meet a 50-percent threshhold for its reserves (sec. 816). More than 50 percent of its reserves must constitute life insurance reserves or reserves for noncancellable accident and health policies. An insurance company that does not meet this 50-percent threshhold for reserves generally is subject to tax as a property and casualty insurance company. In determining the amount of premiums earned for purposes of calculating its taxable income, a property and casualty insurance company includes in unearned premiums the amount of life insurance reserves determined under the rules applicable to life insurance companies (secs. 832(b)(4), 807).

Description of Proposal

The proposal provides that the life insurance company proration rules, rather than the property and casualty insurance proration rules, apply with respect to life insurance reserves of a property and casualty company.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2003.

Date: 5/9/2003 12:45 PM
Sender: Carla Martin
To: #ALL STAFF (Rep & Dem); Alan_Cohen@finance-dem.senate.gov; Alisa_Blum@finance-dem.senate.gov; Andrea_Cohen@finance-dem.senate.gov; Andy_Harig@finance-dem.senate.gov; Anita_HornRizek@finance-dem.senate.gov; Bill_Dauster@finance-dem.senate.gov; Brian_Pomper@finance-dem.senate.gov; Dawn_Levy@baucus.senate.gov; Doug_Steiger@finance-dem.senate.gov; Jeff_Forbes@finance-dem.senate.gov; John_Angell@finance-dem.senate.gov; Jonathan_Selib@finance-dem.senate.gov; Jon_Blum@finance-dem.senate.gov; Josh_LeVasseur@finance-dem.senate.gov; Kate_Kirchgraber@finance-dem.senate.gov; Lara_Birkes@finance-dem.senate.gov; Laura_Hayes@finance-dem.senate.gov; Liz_Fowler@finance-dem.senate.gov; Liz_Liebschutz@finance-dem.senate.gov; Mark_Kirbabas@finance-dem.senate.gov; Matt_Jones@finance-dem.senate.gov; Mick_Wiedrick@finance-dem.senate.gov; Pat_Bousliman@finance-dem.senate.gov; Pat_Heck@finance-dem.senate.gov; Renee_Johnson@finance-dem.senate.gov; Rhonda_Sinkfield@finance-dem.senate.gov; Russ_Sullivan@finance.senate.gov; Shara_Aranoff@finance-dem.senate.gov; Tim_Punke@finance-dem.senate.gov; Tom_Klouda@finance-dem.senate.gov
Priority: Normal
Subject: Results of Markup

Results of Markup
May 8, 2003

Tax and Jobs Growth Act of 2003

Modification of Chairman's Mark, approved without objection

Breaux Amendment (Amendment not filed). Description: Strike Section 1B of JCX-46-03, the Additional Chairmans Modification. Approved by roll call vote, 12 ayes, 8 nays, 1 present
Ayes: Hatch (proxy), Smith, Baucus, Rockefeller, Daschle (proxy), Breaux, Conrad, Graham, Jeffords (proxy), Bingaman, Kerry, Lincoln
Nays: Grassley, Nickles, Snowe, Kyl, Thomas, Santorum, Frist (proxy), Bunning
Present: Lott

Graham #1, Amendment #108. Defeated by Roll Call Vote, 7 Ayes, 14 Nays.
Ayes: Rockefeller, Daschle (proxy), Breaux, Graham, Jeffords (proxy), Bingaman, Kerry
Nays: Grassley, Hatch (proxy), Nickles, Lott, Snowe, Kyl (proxy), Thomas, Santorum, Frist (proxy), Smith, Bunning, Baucus, Conrad, Lincoln

Baucus #3, Amendment #43. Defeated by Roll Call Vote, 10 Ayes, 11 Nays
Ayes: Baucus, Rockefeller (proxy), Daschle (proxy), Breaux (proxy), Conrad, Graham (proxy), Jeffords, Bingaman, Kerry (proxy), Lincoln.
Nays: Grassley, Hatch (proxy), Nickles, Lott (proxy), Snowe, Kyl (proxy), Thomas (proxy), Santorum, Frist (proxy), Smith, Bunning

Conrad #4, Amendment 107. Defeated by Roll Call Vote, 10 Ayes, 11 Nays
Ayes: Baucus, Rockefeller (proxy), Daschle (proxy), Breaux, Conrad, Graham (proxy), Jeffords, Bingaman, Kerry (proxy), Lincoln
Nays: Grassley, Hatch (proxy), Nickles, Lott (proxy), Snowe, Kyl (proxy), Thomas, Santorum, Frist (proxy), Smith, Bunning

Jeffords #1. Amendment 109. Defeated by Roll Call Vote. 10 Ayes, 11 Nays
Ayes: Baucus, Rockefeller (proxy), Daschle, Breaux, Conrad, Graham (proxy), Jeffords, Bingaman, Kerry (proxy), Lincoln (proxy)
Nays: Grassley, Hatch (proxy), Nickles, Lott (proxy), Snowe, Kyl (proxy), Thomas, Santorum, Frist (proxy), Smith, Bunning

Daschle #3, Amendment 92. Defeated by Roll Call Vote. 9 Ayes, 11 Nays, 1 Pass
Ayes: Baucus, Rockefeller (proxy), Daschle, Breaux, Conrad, Graham (proxy), Jeffords, Kerry (pass), Lincoln
Nays: Grassley, Hatch (proxy), Nickles, Lott (proxy), Snowe, Kyl (proxy), Thomas, Santorum, Frist (proxy), Smith, Bunning.

Bingaman #1, Amendment 111. Defeated by Roll Call Vote, 10 Ayes, 11 Nays
Ayes: Baucus, Rockefeller (proxy), Daschle (proxy), Breaux, Conrad, Graham (proxy), Jeffords, Bingaman, Kerry (proxy), Lincoln
Nays: Grassley, Hatch (proxy), Nickles, Lott (proxy), Snowe, Kyl (proxy), Thomas, Santorum, Frist (proxy), Frist (proxy), Smith, Bunning (proxy).

Bingaman #3, Amendment 113. Defeated by Roll Call Vote, 9 Ayes, 11 Nays, 1 pass
Ayes: Baucus, Daschle (proxy), Breaux, Conrad, Graham (proxy), Jeffords, Bingaman, Kerry (proxy), Lincoln
Nays: Grassley, Hatch (proxy), Nickles, Lott, Snowe, Kyl (proxy), Thomas, Santorum, Frist (proxy), Smith, Bunning
Pass: Rockefeller

Rockefeller #8, Amendment 68. Defeated by Roll Call Vote, 10 Ayes, 11 Nays
Ayes: Baucus, Rockefeller, Daschle, Breaux, Conrad, Graham (proxy), Jeffords, Bingaman (proxy), Kerry (proxy), Lincoln
Nays: Grassley, Hatch, Nickles, Lott, Snowe, Kyl, Thomas, Santorum, Frist, Smith, Bunning

Rockefeller Amendment. Amendment not filed. Description: FMAP tied to tax policy. Defeated by Roll Call Vote, 9 Ayes, 12 Nays
Ayes: Baucus, Rockefeller, Daschle, Breaux, Graham, Jeffords, Bingaman (proxy), Kerry (proxy), Lincoln
Nays: Grassley, Hatch, Nickles, Lott, Snowe, Kyl, Thomas, Santorum, Frist, Smith, Bunning, Conrad

Breaux Amendment. Amendment not filed. Description: Add Puerto Rico to the Gordon Smith Amendment, Approved by Roll Call Vote, 12 Ayes, 6 Nays, 3 Pass
Ayes: Grassley, Hatch, Lott, Santorum, Frist, Baucus, Rockefeller, Daschle, Breaux,

Conrad, Jeffords, Lincoln
Nays: Nickles, Snowe, Kyl, Thomas, Smith, Bunning
Pass: Graham, Bingaman, Kerry

Smith #1, Amendment #29. Defeated by Roll Call Vote, 10 Ayes, 11 Nays.
Ayes: Grassley, Hatch, Lott, Kyl, Santorum, Frist, Smith, Bunning, Baucus, Breaux
Nays: Nickles, Snowe, Thomas, Rockefeller, Daschle, Conrad, Graham (proxy), Jeffords, Bingaman (proxy), Kerry (proxy), Lincoln

Smith #6, Amendment 34. Approved by voice vote.

Managers Amendment. Approved by voice vote.

Chairman's mark as amended. Approved by voice vote.
Final Passage, Approved by Roll Call Vote, 12 Ayes, 9 Nays
Ayes: Grassley, Hatch, Nickles, Lott, Snowe, Kyl, Thomas, Santorum, Frist, Smith, Bunning, Lincoln
Nays: Baucus, Rockefeller, Daschle, Breaux, Conrad, Graham (proxy), Jeffords, Bingaman (proxy), Kerry (proxy)