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H.R. 3996 - Temporary Tax Relief Act of 2007

EXECUTIVE SUMMARY

This legislation was introduced by Representative Charles Rangel (D-NY) on October 30, 2007. The bill was ordered to be reported, as amended, by a vote of 22 - 13, by the Committee on Ways and Means on November 2, 2007. H.R. 3996 is expected to be considered on the floor under a structured rule on November 9, 2007.

The bill would extend for one year AMT relief for nonrefundable personal credits and increases the AMT exemption amount to $66,250 for joint filers and $44,350 for individuals, which is estimated to cost $50.59 billion over 10 years. House Ways and Means Committee Republicans expressed opposition to the array of tax increases in the bill, including 1) the carried interest taxation; and 2) delayed implementation of interest allocation. The bill also revokes the IRS' authority to enter into contracts with private tax collectors.

The Administration issued a veto threat for H.R. 3996, arguing that it imposes "additional tax burdens [that] would undermine the competitiveness of U.S. businesses in the global economy and could have adverse effects on the U.S. economy."

The Congressional Budget Office (CBO) and the Joint Committee on Taxation estimate that H.R. 3996 will increase revenues by $3.1 billion over the 2008-2012 period and increase direct spending by $2.7 billion over the 2008-2012 period.

FLOOR SITUATION

H.R. 3996 is being considered on the floor under a structured rule. The Rule:

- Provides one hour of general debate equally divided and controlled by the Chairman and Ranking Republican Member of the Ways and Means Committee.

- Waives all points of order against consideration of the bill except those arising under clauses 9 (earmarks) and 10 (PAYGO) of Rule XXI.

- Provides that the amendment in the nature of a substitute recommended by the Committee on Ways and Means now printed in the bill shall be considered as adopted and the bill, as amended, shall be considered as read.

- Waives all points of order against provisions of the bill, as amended. This waiver does not affect the point of order available under clause 9 of rule XXI (regarding earmark disclosure).

- Makes in order an amendment in the nature of a substitute if offered by Rep. McCrery (R-LA) or his designee.

- Provides that the substitute amendment shall be considered as read and shall be debatable for one hour equally divided and controlled by the proponent and an opponent.

- Provides one motion to recommit with or without instructions.

- Provides that, notwithstanding the operation of the previous question, the Chair may postpone further consideration of the bill to a time designated by the Speaker.

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H.R. 3996 is expected to be considered on the floor of the House of Representatives on November 9, 2007.

SUMMARY

Increasing the AMT Threshold: H.R. 3996 raises the income threshold above which taxpayers may be subject to the Alternative Minimum Tax (AMT). The amount of income a taxpayer can make and still be exempt from the AMT is increased from $42,500 to $44,350 for individuals and is increased from $62,550 to $66,250 for couples that file a joint tax return. The bill will also extend the AMT relief for nonrefundable personal credits for one year through taxable year 2007.

Lowering the Threshold to Qualify for the Child Tax Credit: The bill reduces the income threshold for how much income an individual must earn before they can qualify for the refundable child tax credit from $10,000 to $8,500 for taxable year 2008.

New Tax Deduction for Property Taxes: The bill introduces a new standard tax deduction for State and local property taxes of up to $350 for individuals and up to $700 for couples that file a joint tax return.

Expansion of allowance for state legislators' expenses away from home: The bill would expand the definition of "in session" to include pro forma days for purposes of determining whether a state legislator can claim a tax deduction of allowable "per diem" expenses. Generally, per diem amounts are deductible whether or not the legislator actually incurs any expense. This provision overturns the current IRS rule requiring a quorum be present for legislators to deduct travel expenses.

<u>One Year Extensions of Existing Tax Programs</u>: The bill extends various tax deductions, credits, and rules that are set to expire on December 31, 2007, for one year, until December 31, 2008, including:

- Deduction for state and local sales taxes
- Tax deduction for qualified tuition and related expenses
- The penalty tax on group health care plans that fail to comply with mental health parity requirements
- Tax exclusion of charitable contributions from an Individual Retirement Account (IRA)
- Tax deduction for certain expenses of elementary and secondary school teachers
- Special rules that allow members of the armed services to treat combat pay as earned income for the purposes of qualifying for the Earned Income Tax Credit (EITC)
- Special rules that allow veterans to qualify for state-operated, tax-exempt mortgage bonds
- Special rules that allow active duty reservists to make penalty free withdrawals from their retirement plans
- The Research and Development Tax Credit
- The Indian Employment Tax Credit, which aims to provide an incentive for employers to hire certain individuals who live on or near an Indian reservation
- Expensing of "brownfields" environmental cleanup costs
- The American Samoa economic development credit
- Special rule providing a tax deduction for S-Corporations that make charitable donations of property
- The work opportunity tax credit that allows employers to claim the work opportunity tax credit for hiring employees who were affected by Hurricane Katrina

  **Note: This provision expired in August of 2007.*

- Authorization for the Social Security Administration (SSA) to disclose tax return information to the Department of Veterans Affairs for the purposes of determining eligibility for certain veterans' programs

- Authorization for the Internal Revenue Service (IRS) to conduct certain undercover operations

Tax Benefits for Certain Enterprise Zones in the District of Columbia: H.R. 3996 extends tax incentives for businesses and individuals that are located within designated "Enterprise Zones" in the District of Columbia, and the bill extends the $5000 first time homebuyer tax credit for the District of Columbia.

Clarification of unused merchandise drawback**:** The bill would clarify that wine of the same color shall be deemed to be commercially interchangeable for purposes of duty drawback.

Increase of AMT Refundable Credit Amount**:** Under present law, taxpayers with long-term unused AMT credit may claim an AMT refundable credit in the amount of the greater of (1) the lesser of $5,000 or the amount of unused AMT credits, and (2) 20 percent of the unused AMT credits. The credit is phased-out for taxpayer's with adjusted gross income in excess of $156,400 in 2007 ($234,600 for joint filers). The provision would repeal the phase-out and allow taxpayers to claim an unused AMT credit in the amount of the greater of (1) 50 percent of the amount of unused AMT credits, and (2) the amount, if any, of the AMT refundable credit claimed by the taxpayer for the taxpayer's preceding taxable year. *This proposal is estimated to cost $2.26 billion over 10 years.*

Tax Benefits for Individuals Who Receive Mortgage Debt Forgiveness: The bill relieves individuals who receive mortgage debt forgiveness from having the sum of the forgiven debt treated as taxable income, effective for debts forgiven on or after January 1, 2007, and extends the tax deduction for the cost of private mortgage insurance for certain low-income individuals through the end of 2014. H.R. 3996 lowers the threshold for buildings to qualify as cooperative housing corporations, which thereby allows tenants of the corporations to receive tax deductions on their proportionate share of real estate taxes and mortgage interest paid on the property and limits the current capital gains tax exemption on the sale of a second home.

**Note: Identical mortgage debt relief provisions were contained in H.R. 3648, which passed in the House of Representatives on October 4, 2007 by a vote of 386 - 27 (Roll No. 948), Click here for the legislative digest on H.R. 3648.*

Revoking the IRS' Authority to Enter Into Contracts With Private Tax Collectors
H.R. 3996 repeals the Internal Revenue Service's (IRS) authority to enter into contracts with private debt collectors, effective July 18, 2007. Any contracts entered into before that date are not authorized to be renewed or extended, and any contracts entered into after that date will be void.

- Cost: The Joint Committee on Taxation (JCT) estimated that an identical provision contained in H.R. 3056, which passed in the House by a vote of 232 - 173 (Roll no. 960) on October 10, 2007, would **reduce** federal revenues by $1.3 billion over the 2008-2017 period. Click here for the legislative digest on H.R. 3056.

**Note: Republicans on the Ways and Means Committee "strongly oppose [this] provision killing the private collection agency program." Republicans stated that hearings on the issue revealed that "tax liabilities assigned to PCAs [Private Collection Agencies] for collection would otherwise go uncollected even if the IRS had a greater enforcement budget." Also in the hearings it was found that private debt collection firms are currently "successfully collecting millions of dollars in unpaid taxes that the IRS would not otherwise pursue."*

Delaying the Implementation of the 3% Withholding on Certain Government Payments
The bill delays the effective date from January 1, 2011 to January 1, 2012 of the implementation of a provision of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222), which requires the government to withhold 3% of government payments for certain goods and services.

H.R. 3996 also requires the Secretary of the Treasury to report to Congress within six months of the enactment of this Act on any anticipated problems or burdens that may arise in administering or complying with the implementation of the 3% withholding provision.

- Cost: The JCT estimated that an identical provision contained in H.R. 3056, which passed in the House by a vote of 232 - 173 (Roll no. 960) on October 10, 2007, **reduce** federal revenues by $44 million over the 2008-2017 period. Click here for the legislative digest on H.R. 3056.

Taxpayers in the United States Virgin Islands
The bill clarifies that effective for tax years 1986 through present, tax returns from residents of the United States Virgin Islands will be treated "in the same manner as if such return were an income tax return filed in the United States for such taxable year." This provision is intended to clarify a discrepancy created by conflicting guidance published by the IRS on certain income tax filing procedures for residents of the United States Virgin Islands.

- Cost: The JCT estimated that an identical provision contained in H.R. 3056, which passed in the House by a vote of 232 - 173 (Roll no. 960) on October 10, 2007, would **reduce** federal revenues by $38 million over the 2008-2017 period. Click here for the legislative digest on H.R. 3056.

Tax Increase on Individuals Who Renounce Their Citizenship

H.R. 3996 would require that property owned by individuals who renounce their United States citizenship is treated, for tax purposes, as though it were sold for its market value on the day before the citizen expatriates. The bill also adds a new tax on expatriates as soon as they move overseas.

- Cost: The JCT estimated that an identical provision contained in H.R. 3056, which passed in the House by a vote of 232 - 173 (Roll no. 960) on October 10, 2007, estimates that this provision would **increase** federal revenues by $764 million over the 2008-2017 period. Click here for the legislative digest on H.R. 3056.

Increasing the Amount of Time Interest Accrues on Unpaid Taxes
H.R. 3996 would remove the current limit of three years for which interest accrues on unpaid taxes. This change in current law will allow interest on unpaid taxes to continue to accrue beyond three years.

- Cost: The JCT estimated that an identical provision contained in H.R. 3056, which passed in the House by a vote of 232 - 173 (Roll no. 960) on October 10, 2007, would **increase** federal revenues by $128 million over the 2008-2017 period. Click here for the legislative digest on H.R. 3056.

Requires Taxes to be Paid on a Current Basis on Deferred Compensation: The bill will require individuals that receive deferred compensation from a non-taxed party to pay tax on that compensation on a current basis, as opposed to current law that permits the taxes to be deferred until the compensation is received.

Increasing Taxes Paid on Carried Interest: The bill establishes new rules that will increase the taxes paid on *carried interest*, which is a tax levied on investment partnerships. The bill would require these partnerships to treat carried interest as ordinary income (taxed at 35%) as opposed to current law that treats carried interest as capital gains (taxed at 15%).

Eliminating the Unrelated Business Income Tax (UBIT) on Certain Investment Partnerships: The bill will eliminate the current requirement that investment partnerships, including pension plans, universities, and other tax-exempt entities, pay a UBIT-tax when they invest in hedge funds and other investment funds, as these investments are regarded as "unrelated" to the organization's tax exempt purpose.

Treatment of certain gain on sales between related persons as ordinary income as a result of tax sharing agreements**:** Under current law, if a taxpayer sells depreciable property to a related person, any gain recognized on that transfer will be ordinary income. The bill would treat taxpayers as being related if there is a tax sharing agreement between the parties that provides for the payment to the transferor of any amount which is determined by reference to the tax benefit realized by the transferee as a result of depreciating the property transferred. *This proposal is estimated to raise $135 million over 10 years.*

Further Delays Implementation of a Tax Cut for Certain Individuals with Foreign Sources of Income: In 2004, Congress authorized a change in the way costs stemming from interest between United States sources and foreign sources of income are treated for the purposes of determining a taxpayer's foreign tax credit eligibility. This implementation of this tax benefit was delayed until tax year 2008, and H.R. 3996 will further delay its implementation until after 2017.

Requiring Cost Basis Reporting: The bill will require that starting on January 1, 2009 brokers of securities trades to begin "cost basis reporting," a method of calculating taxable gains or losses on securities trades that includes dividends and capital gains distributions in the calculation of the cost of a security transaction and increases an individuals taxable income.

Penalty for S corporations and partnerships filing late returns**:** The bill would impose a $25 penalty per S Corporation shareholder for each month the S Corporation fails to file a tax return. The provision also increases the failure-to-file penalty for partnerships by $25 per partner (for a total of $75 per month). *This proposal is estimated to raise $507 million over 10 years.*

BACKGROUND

The Alternative Minimum Tax (AMT) was created in 1969 to ensure that higher-income individuals and families did not utilize the tax code to unfairly avoid tax liability. It serves as a companion tax to the regular income tax. The AMT rates and exemptions, however, have never been properly indexed for inflation, resulting in more and more middle-income earners becoming subject to the AMT.

According to the Congressional Research Service, the AMT impacted fewer than 20,000 taxpayers when first implemented. In 2006 it applied to roughly 4.2 million taxpayers and is projected to affect over 23 million in 2007 unless it is addressed.

The Tax Reform Act of 1986 substantially changed the AMT by increasing the tax rate to 21%, changing the basic exemption amount, broadening the tax base, and revamping the AMT credit. It also introduced a phase-out of the AMT exemption amount for taxpayers whose AMT taxable income exceeded certain limits.

Since 1998, the AMT has been mitigated through temporary provisions allowing certain personal tax credits to offset AMT liability and temporary increases in the basic exemption for the AMT. Congress last enacted an AMT "patch" as part of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-122), which extended the fix through 2006.

ADDITIONAL VIEWS

The Administration issued a veto threat for H.R. 3996, arguing that it imposes "additional tax burdens [that] would undermine the competitiveness of U.S. businesses in the global economy and could have adverse effects on the U.S. economy." (Statement of Administration Policy: H.R. 3996, 11/08/2007)

COST

The Congressional Budget Office (CBO) and the Joint Committee on Taxation estimate that H.R. 3996 will increase revenues by $3.1 billion over the 2008-2012 period and increase direct spending by $2.7 billion over the 2008-2012 period. (CBO Estimate: H.R. 3996, 11/06/2007)

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