MEMORANDUM

To: Reporters and Editors

From: Carol Guthrie for Finance Committee Chairman Max Baucus (D-Mont.)
Jill Gerber for Finance Committee Ranking Republican Chuck Grassley (R-Iowa)

Re: update on tax amendments to S. 1591

Please note that at approximately 6:45 Tuesday evening, the Kennedy amendment (SA 680) to the U.S. Troops Readiness, Veterans' Health and Iraq Accountability Act (S. 1591) was accepted by voice vote, thus attaching H.R. 2, the Senate work product on the minimum wage increase and small business tax incentives, to the supplemental spending bill. The Kennedy amendment as written made no changes to the minimum wage bill passed by the Senate. A summary of the tax relief provisions and offsets in the original bill, and so in the Kennedy amendment, is on the web at http://finance.senate.gov/press/Bpress/2007press/prb011807legb.pdf.

Prior to the Kennedy amendment's acceptance, a second-degree Grassley-Baucus amendment (SA 798) was added to the Kennedy amendment by unanimous consent. This second-degree amendment provides additional tax incentives for small businesses, along with various offsets. A summary of this provision is below.

Summary of Grassley-Baucus 2nd Degree Amendment #798 to Kennedy #680
H.R. 1591, the Emergency Supplemental

Amendment is the Senate-passed HR 2 plus additional, offset tax relief of $3.9 billion over 10 years. Additional proposals include:

1. Depreciation and Cost Recovery provisions. The Senate-passed H.R. 2 provided for certain depreciation and cost recovery provisions through March 31, 2008. The amendment would extend these provisions through December 31, 2008. The provisions include the following:
    - 15-year cost recovery period for qualified leasehold and restaurant improvements;
    - 15-year recovery period for new restaurant buildings; and
    - 15-year recovery period for retail improvements.

2. Tax relief for rural out-migration counties. The amendment provides for two new tax incentive proposals for counties with declining populations ("outmigration counties"):

- Expand Work Opportunity Tax Credit to include outmigration counties (sunset 12/31/12);
- Shorten the useful lives for cost recovery purposes for property placed in service in outmigration counties.

3. Extension of GO Zone Small Business Expensing. The proposal extends the placed-in-service date for certain qualified section 179 Gulf Opportunity Zone property to December 31, 2008. The proposal applies to property substantially all of the use of which is in one or more specified portions of the GO Zone. The specified portions of the Go Zone means those portions of the Go Zone which are in any county or parish identified by the Treasury Secretary as those in which the 2005 hurricanes damaged, in the aggregate, more than 60 percent of the housing units in the county or parish that were occupied. The proposal applies to property placed in service after December 31, 2007 and before January 1, 2009.

4. Deductibility of interest expense on indebtedness incurred by an acquiring business trust to acquire S corporation stock. The proposal enables an electing small business trust ("ESBT") to deduct interest expense it incurs when it borrows funds to purchase S corporation stock. All other taxpayers and qualified S corporation trusts are currently entitled to deduct interest incurred to acquire S corporation stock. The current disallowance of the deduction for such interest by an ESBT is reversed and given consistent treatment with other S corporation shareholders.

5. Expansion of Kiddie tax. The proposal would expand the "kiddie tax" to cover the same group of individuals as the House bill (H.R. 976, included in the House-passed emergency supplemental) with respect to higher dividends and capital gains rates. In 1986, Congress enacted the "kiddie tax" as a response to parental abuse of tax rates. Some individuals were transferring large amounts of unearned income, such as dividend and capital gains proceeds, to their children's accounts to ensure taxation at their kids' lower tax rates. In '86, Congress shut down this abuse for children under age 14. The Tax Increase Prevention and Reconciliation Act (TIPRA) of 2005 expanded this to children ages 14 to under 18. The proposed offset would expand this provision to include individuals under age 19 (24 if a student) who provide less than half their support with earned income. This is the same class of individuals that the House bill would impact with higher dividends and capital gains rates, but this proposal would apply to all

unearned income (not just dividends and capital gains) and, unlike the House bill, would allow the lower dividends and capital gains rates to apply if the parents are eligible for the lower rates.

6. Tax Gap proposals. The amendment includes the following eight tax gap proposals included in the President's FY 2008 budget.

- Increased information return penalties;
- Increased penalties for failure to file Form 990;
- Require e-filing by certain large businesses;
- Allow IRS access to information in the National Directory of New Hires;
- Permit disclosure of prison tax scams;
- Expand preparer penalties;
- Impose penalty on failure to comply with electronic filing requirements;
- Establish penalties for filing erroneous refund claims.

7. Repeal suspension of certain deficiency interest. In general, the IRS may charge interest and certain penalties on tax deficiencies that are determined after a tax return is filed, e.g., as the result of an audit. IRC 6404(g) provides that the IRS must stop charging interest and certain penalties if a taxpayer is not notified of the deficiency within 18 months of filing. Only after the taxpayer is notified of the deficiency do the interest charges start up again. This provision was enacted in the IRS Restructuring and Reform Act of 1998 in response to complaints that the IRS acted too slowly, causing unnecessary interest charges to build up on taxpayers. The amendment would extend the period that the IRS has to notify the taxpayer from 18 months to 36 months.

8. Other tax administration and enforcement provisions. The amendment includes the following other tax enforcement and administration provisions:

- Termination of installment agreements;
- Office of chief counsel review of offers-in-compromise;
- Authorization for financial management service retention of transaction fees from levied amounts;
- Extension of IRS authority to fund undercover operations (sunset 12/31/08);

- Increase in penalty excise taxes on the political and excess lobbying activities of section 501(c)(3) organizations (part of S. 1321 in 109th Congress);
- Direct the Commissioner of the Internal Revenue Service to give additional consideration to awarding contracts for private debt collection to companies that hire the disabled.