H.R. 4849
"Small Business and Infrastructure Jobs Tax Act of 2010"

March 22, 2010

I. SMALL BUSINESS TAX INCENTIVES

General Provisions

100% Exclusion of small business capital gains. Under current law, Section 1202 provides a fifty-percent (50%) exclusion for gain from the sale of certain small business stock that is held for more than five years. The amount of gain eligible for the Section 1202 exclusion is limited to the greater of 10 times the taxpayer's basis in the stock, or $10 million gain from stock in that small business corporation. This provision is limited to individual investments and not the investments of a corporation. The non-excluded portion of section 1202 gain is taxed at the lesser of ordinary income rates or 28 percent, instead of the lower capital gains rates for individuals. The *American Reinvestment and Recovery Act* (the "Recovery Act") temporarily increased the Section 1202 exclusion to seventy-five percent (75%) for qualifying stock acquired in 2009 and 2010. The bill would temporarily increase the amount of the exclusion to one hundred percent (100%) for qualifying stock acquired after March 15, 2010 and before January 1, 2012. *This provision is estimated to cost $1.962 billion over 10 years.*

Limitations and Reporting on Certain Penalties

Small business penalty relief. Under current law, Section 6707A of the Internal Revenue Code imposes a penalty on the failure to disclose a "reportable transaction" on any tax return or information statement. There are six categories of reportable transactions, one of which is a "listed transaction." A "listed transaction" is a type of transaction identified by the IRS through guidance as a tax avoidance transaction. The penalty for failure to disclose a reportable transaction (other than a listed transaction) on a return is $10,000 in the case of individuals and $50,000 in any other case. For listed transactions, the penalty is $100,000 in the case of individuals and $200,000 in any other case. The bill generally would make the penalty for failing to disclose reportable transactions (including listed transactions) proportionate to the underlying tax savings. *This provision is estimated to cost $176 million over 10 years.*

Annual reports on penalties and certain other enforcement actions. Under current law, the Internal Revenue Service is not required to report annually to the Congress on penalties assessed during the year. The bill would require the IRS Commissioner to report annually to the Ways and Means Committee and the Senate Finance Committee on penalties assessed, and

enforcement actions taken, with respect to tax shelters. *This provision is estimated to have no revenue effect.*

Other Provisions

SBA non-recourse loans treated as at-risk. Under current law, business expenditures are deductible against related business income even if they are financed with non-recourse debt. However, in order to prevent taxpayers from engaging in certain types of tax shelters, Congress enacted the "at-risk" rules to prevent taxpayers from using expenses financed with non-recourse debt to shelter unrelated income. There are exceptions to the at-risk rules in situations where Congress believed that, even though a project was financed with non-recourse debt, that it is likely that the financing will be repaid and that the purchaser will have real equity in property financed with the non-recourse debt (e.g., real estate). The bill would provide an exception to the "at-risk" rules for non-recourse loans that are guaranteed by the Small Business Administration (SBA). The passive activity loss rules would still apply to these expenses to prevent taxpayers from engaging in tax shelter transactions. *This provision is estimated to cost $942 million over 10 years.*

Increase deduction for start-up expenditures. Under current law, taxpayers may deduct up to $5,000 in trade or business start-up expenditures. The amount that a business may deduct is reduced by the amount by which start-up expenditures exceed $50,000. Start-up expenditures are defined as expenses paid or incurred in connection with investigating the creation of a business, and do not include expenses that would otherwise be allowed to be expensed (i.e., capital or equipment investments). For taxable years beginning in 2010 or 2011, the bill would increase the limit on the tax deduction for trade or business start-up expenditures from $5,000 to $20,000, and increase threshold amount for reducing such limit to $75,000. *This provision is estimated to cost $508 million over 10 years.*

II. INFRASTRUCTURE

Extension of Build America Bonds ("BABs"). The Federal government provides significant financial support to State and local governments through the federal tax exemption for interest on municipal bonds. Both tax credit bonds and tax-exempt bonds provide a subsidy to States and municipalities by reducing the cash interest payments that a State or local government must make on its debt. Tax credit bonds differ from tax-exempt bonds in two principal ways: (1) interest paid on tax credit bonds is taxable; and (2) a portion of the interest paid on tax credit bonds takes the form of a Federal tax credit. The Federal tax credit offsets a portion of the cash interest payment that the State or local government would otherwise need to make on the borrowing. For 2009 and 2010, the Recovery Act provided State and local governments with the option of issuing Build America Bonds as a tax credit bond that provides a Federal tax credit to investors equal to 35% of the coupon interest payable by the issuer of the bond. Because the demand for tax credits has been small given current economic conditions, the Recovery Act also allowed the State or local government to issue Build America Bonds as a taxable bond and

receive a direct payment from the Federal government equal to 35% of the total interest payable to investors on the bond. The bill would extend these provisions to allow Build America Bonds to be issued in 2011, 2012, and before April 1, 2013. For direct-pay Build America Bonds issued in 2011, the amount of the direct payment would be reduced from 35% to 33% of the coupon interest. For such bonds issued in 2012, the amount of the direct payment would be reduced further to 31% of the coupon interest. For bonds issued after January 1, 2013 and before April 1, 2013, the amount of the direct payment would be reduced further to 30% of the coupon interest. The bill would also allow issuers to issue Build America Bonds to effect a current refunding of outstanding Build America Bonds; as a result, issuers and the Federal government could save money if interest rates fall in the future. *This provision is estimated to cost $7.460 billion over 10 years.*

Water and sewer exempt-facility bonds excluded from state volume caps. Under current law, States agencies are generally subject to a cap with respect to the volume of private activity bonds they may issue. Certain bonds are not subject to these state volume caps. For example, bonds to finance airports, docks and wharves are excluded from state volume caps. Furthermore, qualified veterans' mortgage bonds and qualified 501(c)(3) bonds are also excluded from state volume caps. The bill would exclude bonds financing facilities that furnish water and sewage facilities from state volume caps. The bill would also exclude bonds financing facilities that furnish water and sewage facilities from certain limitations on tribal government issuances. *This provision is estimated to cost $372 million over 10 years.*

Eliminate costs imposed on State and local governments by the alternative minimum tax. The alternative minimum tax (AMT) can increase the cost to State and local governments of issuing tax-exempt private activity bonds. In general, interest on tax-exempt private activity bonds is generally subject to the AMT. This limits the marketability of these bonds and, therefore, forces State and local governments to issue these bonds at higher interest rates. In 2008, Congress excluded one category of private activity bonds (i.e., tax-exempt housing bonds) from the AMT. The Recovery Act excluded the remaining categories of private activity bonds from the AMT if the bond is issued in 2009 or 2010, and allowed AMT relief for current refunding of private activity bonds issued after 2003 and refunded during 2009 and 2010. The bill would extend both of these Recovery Act provisions for one year (i.e., exempt from AMT tax-exempt private activity bonds issued in 2011 and current refunding of private activity bonds issued after 2003 and refunded during 2011). *This provision is estimated to cost $224 million over 10 years.*

Elective payments in lieu of low-income housing credits. The Recovery Act allowed state housing agencies to elect to receive a payment in lieu of a portion of the State's allocation of low-income housing tax credits. As part of H.R. 4213, both the House of Representatives and the Senate have voted to extend this program for an additional year (through 2010). In addition to the low-income housing tax credits that are allocated to each State, low-income housing buildings that are financed with tax-exempt bonds are also eligible for an automatic allocation of low-income housing tax credits. The bill would allow owners of tax-exempt bond-financed buildings, placed in service after date of enactment and prior to December 31, 2010, to elect to

receive a direct payment in lieu of these tax credits. The amount of the direct payment would be equal to eighty-five percent (85%) of the present value of the low-income housing tax credits that would otherwise have been awarded with respect to such building. *This provision is estimated to cost $2.372 billion over 10 years.*

Extension and additional allocation of Recovery Zone bonds. The Recovery Act created a new category of tax credit bonds for investment in economic recovery zones. The Recovery Act authorized $10 billion in recovery zone economic development bonds and $15 billion in Recovery Zone facility bonds. These bonds could be issued during 2009 and 2010. Each state received a share of the national allocation based on that state's job losses in 2008 as a percentage of national job losses in 2008 (each state received a minimum allocation of these bonds). These allocations were then sub-allocated to local municipalities. Municipalities receiving an allocation of these bonds would be permitted to use these bonds to invest in infrastructure, job training, education, and economic development in areas within the boundaries of the State, city or county (as the case may be) that has significant poverty, unemployment or home foreclosures. Because the formula that was used in the Recovery Act looked to net job losses instead of unemployment, some areas of the country with significant numbers of unemployed individuals did not receive any allocation of Recovery Zone bonds. The bill would make an additional allocation of Recovery Zone bonds to ensure that each local municipality receives a minimum allocation equal to at least its share of national unemployment in December 2009. The bill would also extend the authorization for issuing Recovery Zone bonds through 2011. *This provision is estimated to cost $2.385 billion over 10 years.*

New Markets Tax Credits allowed against alternative minimum tax. Through the New Markets Tax Credit (NMTC) program, the federal government is able to leverage federal tax credits to encourage significant private investment in low-income communities. For each dollar of qualified private investment, the NMTC program provides investors with either 5 cents or 6 cents of federal tax credits (depending on the amount of time that has passed since the original investment was made). The value of these tax credits depends on a taxpayer's ability to use these credits to offset tax liability. The NMTC program will not encourage investors to make investments in low-income communities if these investors are unable to use these credits to offset tax liability. Taxpayers that are subject to the alternative minimum tax (AMT) are unable to use NMTC to offset their AMT tax liability. In order to ensure that the NMTC encourages AMT taxpayers to make qualifying investments, the bill would allow NMTC to be claimed against the AMT with respect to qualified investments made between March 15, 2010 and January 1, 2012. *This provision is estimated to cost $349 million over 10 years.*

III. TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF) JOBS AND ASSISTANCE FUND

Extension of the TANF Emergency Contingency Fund. The Recovery Act created an Emergency Contingency Fund (ECF) to help States with increasing expenditures on: basic assistance for families in the Temporary Assistance for Needy Families (TANF) program; short-term, one-time aid for needy families; and subsidized employment programs (such programs

temporarily pay for all or part of the wages of a worker in a public or private job). This Emergency Fund is now scheduled to expire on September 30, 2010. The bill would provide $2.5 billion to continue this fund through FY 2011. A State's maximum allotment from the Fund in FY 2011 would be capped at 30 percent of its annual grant under the TANF program. *This provision is estimated to cost $2.503 billion over 10 years.*

IV. OFFSET PROVISIONS

Limitation on treaty benefits for certain deductible payments. The bill would prevent foreign multinational corporations incorporated in tax haven countries from avoiding tax on income earned in the United States by routing their income through structures in which a United States subsidiary of the foreign multinational corporation makes a deductible payment to a country with which the United States has a tax treaty before ultimately sending these earnings to the tax haven country. This provision is identical to a provision that passed the House of Representatives in November of last year as part of H.R. 3962 by a vote of 220 to 215, and is modified from a previous version approved by the House of Representatives as part of H.R. 2419 (110th Congress) by a vote of 231 to 191 (with 19 House Republicans joining 212 House Democrats in support) to ensure that foreign multinational corporations incorporated in treaty partner countries will not be affected by this provision. *This provision is estimated to raise $7.735 billion over 10 years.*

Clarification of gain recognized in certain spin-off transactions (e.g., "Reverse Morris Trust" transactions). Under current law, taxes are generally imposed on parent corporations where they extract value in excess of basis from their subsidiaries prior to engaging in a tax-free spin-off transaction. Therefore, if a subsidiary corporation distributes cash or other property to its parent in excess of the parent's basis in the subsidiary or if a subsidiary corporation assumes parent debt in excess of the parent's basis in the subsidiary, the parent corporation will recognize gain. However, taxes are not assessed if a subsidiary corporation distributes its own debt securities to a parent corporation prior to a spin off transaction even where the value of these securities would exceed the parent corporation's basis in its subsidiary. The bill would treat distributions of debt securities in a tax-free spin-off transaction in the same manner as distributions of cash or other property. *This provision is estimated to raise $260 million over 10 years.*

Repeal of 80/20 rules. Under current law, dividends and interest paid by a domestic corporation are generally considered U.S.-source income to the recipient and are generally subject to gross basis withholding if paid to a foreign person. If at least eighty percent (80%) of a corporation's gross income during a three-year period is foreign source income and is attributable to the active conduct of a foreign trade or business (a so-called "80/20 company"), dividends and interest paid by the corporation will generally not be subject to the gross basis withholding rules. Furthermore, interest received from an 80/20 company can increase the amount of foreign tax credits that may be claimed by U.S. multinational corporations. The Treasury Department has become aware that some companies have abused the 80/20 company rules. As a result, the President's 2011 Budget proposes to repeal these rules. The bill would adopt the President's

Budget proposal to repeal the 80/20 company rules. The bill would also repeal the 80/20 rules for interest paid by resident alien individuals. *This provision is estimated to raise $950 million over 10 years.*

Increased reporting on expenses related to rental property. Under current law, reporting requirements for rental real estate expenses are limited to taxpayers whose rental real estate activity is considered a trade or business (as opposed to holding real estate for investment). The bill would include tax compliance provisions that would require information reporting on payments of $600 or more to a service provider in the course of earning rental income (such as a plumber, painter, or accountant). Taxpayers would not be subject to this provision with respect to rental payments received with respect to a principal residence. In addition to rental payments received with respect to a principal residence, taxpayers would be allowed to exclude rental payments with respect to one additional residence that they own and use for personal purposes at least part of the year. *This provision is estimated to raise $2.476 billion over 10 years.*

Application of levy to payments to Federal vendors relating to property. The bill would clarify that current law statutory language allowing the IRS to levy one hundred percent (100%) of any payment due to a vendor for goods or services sold or leased to the Federal government would include payments made for the sale or lease of real estate and other types of property not considered "goods or services". *This provision is estimated to raise $147 million over 10 years.*

Application of continuous levy to tax liability of certain Federal contractors. Generally, before the IRS can issue a levy for an unpaid Federal tax liability, it must give the taxpayer an opportunity for a collection due process (CDP) hearing. Prior to making disbursement to Federal contractors, an automated check for a Federal tax liability occurs using the Federal Payment Levy Program. When such a liability is identified, the IRS issues a CDP notice to the contractor but cannot levy payments to the contractor until the CDP requirements are complete. The bill would allow IRS to issue levies prior to a CDP hearing for Federal tax liabilities of Federal contractors. The bill would provide the taxpayer with an opportunity for a CDP hearing within a reasonable time after a levy is issued. *This provision is estimated to raise $1.056 billion over 10 years.*

Require a minimum 10-year term for grantor retained annuity trusts ("GRATs"). Grantor retained annuity trusts ("GRATs") allow taxpayers to structure a transfer of assets to another individual in such a way that substantial gift taxes may be avoided. A GRAT is generally an irrevocable trust in which the grantor retains an annuity interest and transfers a remainder interest to another individual. For gift tax purposes, in valuing the gift of the remainder interest to the beneficiaries of such a trust, current law allows taxpayers to deduct the value of the retained annuity interest from the value of the transferred assets. The value of the retained annuity interest is determined by computing the present value of the annuity at a statutory growth rate. If the property transferred to the trust appreciates in value at a rate that is greater than the statutory growth rate, the excess appreciation will be transferred tax free to the trust beneficiaries. One significant risk to this type of tax planning is that, if the grantor dies during the trust term, the portion of the trust necessary to satisfy the annuity amount is included in the grantor's gross

estate for estate tax purposes. This generally eliminates the benefit of using a GRAT. As a result, taxpayers have created short-term GRATs to maximize their gift tax planning while minimizing the chances that they might die during the trust term. The bill would include the President's 2011 Budget proposal to require a minimum 10-year term for GRATs to significantly limit this type of planning. In connection with requiring a minimum 10-year term, the bill would also require that the value of the remainder interest must be greater than zero and that the annuity must not decrease during the first 10 years of the GRAT term. As a result, the bill would require taxpayers to take on a greater risk that they might die during the GRAT term in order to take advantage of the gift tax benefits of using a GRAT. *This provision is estimated to raise $4.450 billion over 10 years.*

Increase information return penalties. The bill would increase the penalties for failing to file correct returns, failing to furnish correct payee statements, and failing to comply with other information reporting requirements. If a taxpayer fails to file a correct information return before August 1st, current law imposes a $50 penalty per return. The bill would increase this penalty to $100 per information return, with the maximum penalty increased from $250,000 to $1,500,000 (an increase in the maximum penalty from $100,000 to $500,000 in the case of a small business). Where a taxpayer files a correct information return after the filing date but before 30 days after the filing date, the current law $15 penalty will be increased to $30 per return, with a maximum penalty increased from $75,000 to $250,000 per calendar year (an increase in the maximum penalty from $25,000 to $75,000 in the case of a small business). Where a taxpayer files a correct information return more than 30 days after the filing date but before August 1st, the penalty for information returns will be increased from $30 to $60, with a maximum penalty increased from $150,000 to $500,000 (an increase in the maximum penalty from $50,000 to $200,000 in the case of a small business). If the failure is due to intentional disregard of a filing requirement, the current law minimum penalty for each failure is increased from $100 to $250 with no annual limit. This provision is similar to the Treasury Department's proposal to increase penalties on failures to provide information returns. *This proposal is estimated to raise $419 million over 10 years.*

Crude tall oil ineligible for cellulosic biofuel producer credit. In 2008, Congress enacted a $1.01 per gallon tax credit for the production of biofuel from cellulosic feedstocks in order to encourage the development of new production capacity for biofuels that are not derived from food source materials. The House of Representatives has voted on numerous occasions to prevent unprocessed fuels (e.g., black liquor) from claiming this tax credit. Congress is aware that some taxpayers are seeking to claim the cellulosic biofuel tax credit for processed fuels that are highly corrosive, such as crude tall oil (another waste by-product of the paper manufacturing process). The bill would limit eligibility for the tax credit to fuels that are not highly corrosive (i.e., fuels that could be used in a car engine or in a home heating application). *This proposal is estimated to raise $1.885 billion over 10 years.*