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SENATE REPUBLICAN POLICY COMMITTEE

Legislative Notice

No. 2 January 22, 2007

H.R. 2 – "Fair Minimum Wage Act of 2007"

Calendar No. 5

Placed on the Senate Calendar on January 11, 2007.

NOTEWORTHY

- H.R. 2 passed the House on January 10 by a vote of 315 to 116. The House-passed bill is limited to a minimum wage increase. It would increase the federal minimum by $2.10 an hour over 26 months – representing the largest increase in the history of the minimum wage.

- The Senate began consideration of H.R. 2, the Fair Minimum Wage Act of 2007, earlier today. Upon proceeding to the bill, Senator Reid offered a substitute amendment on behalf of Senator Baucus. The Baucus substitute both increases the federal minimum wage and contains the small business tax provisions that were reported by the Finance Committee on January 17.

- On behalf of Senator Gregg, Senator McConnell offered Amdt. No. 101, the Gregg enhanced rescission authority (line item veto). Immediately thereafter, the Majority Leader filed a cloture petition on the amendment. The Majority Leader indicated a cloture vote would occur on the Gregg amendment on Wednesday, at the latest. Amdt. No. 101 differs from the enhanced rescission amendment offered last week to the ethics bill by including a motion to strike specific provisions from the enhanced rescission package sent up by the President.

- Late today, the Majority Leader filed a cloture motion on H.R. 2. The vote on the motion to invoke cloture could occur on Wednesday, January 24. In response, the Republican Leader stated that his hope that cloture would not be invoked on Wednesday. The first Senate vote on the minimum wage bill is expected to occur prior to the policy lunches on Tuesday, January 23.

- The Republican Leader has indicated he hopes for a "full, constructive debate" on this legislation.

Background

Legislation to increase the federal minimum wage was last enacted in August 1996. The 1996 act raised the minimum wage in two steps – a 50-cent increase from $4.25 to $4.75 an hour, followed by an additional 40-cent increase to $5.15 an hour a year later. The 1996 act also included a number of tax and regulatory provisions designed to reduce the impact of the wage increase on small businesses. In fact, in his statement on the signing of the 1996 act, President Bill Clinton stated that the act "creates useful tax incentives for the benefit of small businesses and their employees."[1]

In the 110th Congress, the Democrats have proposed a three-step, 41-percent increase in the federal minimum wage. S. 2 and H.R. 2, identical bills both titled, the Fair Minimum Wage Act of 2007, would raise the hourly rate from its current level of $5.15 an hour to $7.25 an hour over 26 months. H.R. 2 would be the largest increase in the history of the federal minimum wage. H.R. 2 would also raise the minimum wage in the Commonwealth of the Northern Mariana Islands in a series of 6-month increases until it reaches the federal minimum wage level.

On January 10, the House passed an increase in the federal minimum wage by a vote of 315 to 116.

Recent Minimum Wage Votes

During the 109th Congress, the Senate debated and voted on increasing the minimum wage five times.

During consideration of the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" (S. 256), the Senate held two votes tied to the minimum wage. In March 2005, Senator Kennedy proposed an amendment (S.Amdt. 44) to raise the minimum to $7.25 an hour in two steps. The Kennedy amendment also sought to apply the federal minimum wage to the Commonwealth of the Northern Mariana Islands. On March 7, 2005, the Kennedy amendment was defeated by a vote of 46 to 49.[2]

Senator Santorum also offered an amendment to S. 256 as an alternative to the Kennedy amendment. The Santorum amendment would have raised the minimum wage to $6.25 an hour. It also contained a provision to permit compensatory time in lieu of overtime pay, alter the tip credit under the Fair Labor Standards Act, and amend a series of tax and regulatory provisions to counteract the job losses associated with increasing the minimum wage. On March 7, 2005, the Santorum amendment failed by a vote of 38 to 61.[3]

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[1] William J. Clinton, "Statement on Signing the Small Business Job Protection Act of 1996," August 20, 1996. [www.presidency.ucsb.edu/ws/print.php?pid=53209]
[2] William G. Whittaker, Congressional Research Service, "The Fair Labor Standards Act: Minimum Wage in the 109th Congress," RL33401, October 30, 2006.
[3] Whittaker.

In October 2005, Senator Kennedy again offered an amendment to raise the minimum wage in two steps to $7.25 an hour. The Kennedy amendment (S.Amdt. 2063) was offered during Senate consideration of the Fiscal Year 2006 appropriations bill for the Departments of Transportation and the Treasury (H.R. 3058). On this occasion, Senator Kennedy modified his amendment to mirror the amount of the wage increase to that proposed earlier in the year by Senator Santorum. The modified amendment sought an increase to $6.25 an hour. Senator Enzi subsequently offered an amendment that included an increase in the minimum wage to $6.25 an hour, along with a number of tax and regulatory provisions similar to those included in the earlier amendment offered by Senator Santorum. Budget points of order were raised against both amendments. On October 19, 2005, the Kennedy amendment failed on the motion to waive the Congressional Budget Act (CBA) by a vote of 47 to 51.[4] Subsequently, the Enzi amendment failed on the motion to waive the CBA by a vote of 42 to 57.[5]

In June 2006, during consideration of S. 2766, the "National Defense Authorization Act for Fiscal Year 2007," Senator Kennedy again offered an amendment to raise the federal minimum wage. The Kennedy amendment (S.Amdt. 4322) sought to increase the minimum wage to $7.25 an hour, and apply the federal minimum wage to the Commonwealth of the Northern Mariana Islands. Majority Leader Frist stated that the Defense Authorization bill was not the appropriate vehicle to address the minimum wage. Through a series of procedural motions, it was agreed that the Senate would vote on both the Kennedy amendment and one from Senator Enzi. The Enzi amendment (S.Amdt. 4376) matched the one he offered in October 2005. It would have raised the minimum wage to $6.25 an hour, updated the small business exemption under the FLSA, addressed the tip credit, and included a series of tax and regulatory provisions.[6] The Kennedy amendment again failed, this time by a vote of 52 to 46 "since an agreement had been worked out with the Republican leadership that a 60-vote margin would be needed."[7] The Enzi amendment also failed to garner 60 votes. The vote was 45 to 53.

The final vote of the 109th Congress related to the minimum wage issue occurred in August 2006 on H.R. 5970, the "Estate Tax and Extension of Tax Relief Act of 2006." H.R. 5970 provided relief from the estate tax, extended a number of expiring tax provisions, and sought to increase the minimum wage to $7.25 an hour, among other provisions. Despite much debate, the motion to invoke cloture to proceed to the legislation failed on a vote of 56 to 42.[8]

Concerns with Raising the Minimum Wage Without Small Business Help

Opponents of federal legislation to increase the minimum wage argue that, despite the good intentions of helping the working poor, the effect of a minimum wage increase could be the opposite for some workers. There is no question that the minimum-wage workers who keep their jobs would see an increase in hourly pay. However, some could see lower earnings from reduced shifts; others would see reduced benefits. Some would lose their jobs, and others would

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[4] *Congressional Record*, October 19, 2005, S11547.
[5] *Congressional Record*, October 19, 2005, S11548.
[6] Whittaker.
[7] Whittaker.
[8] *Congressional Record*, August 3, 2006, S8746.

be unable to find a job. Raising the minimum wage could prevent some workers from getting their foot on the first rung of the economic ladder.[9]

Research points out that the negative effects of raising the minimum wage would fall most heavily on the shoulders of the most vulnerable workers. When employers are forced to cut employees or reduce hours, they naturally will retain the most skilled and productive employees and not the less-skilled, lower-wage earners. The effect would be harmful to those who have the least ability to get another job, including those who are older, less educated, less trained, and are more often minorities and women.[10]

The largest share of minimum wage earners include teenagers and young adults who just entered the workforce. Based on the most recent data, about one-fourth of minimum-wage earners are teenagers between the ages of 16 and 19, and about one-half are between the ages of 16 and 24.[11] University of Georgia Professor Joseph Sabia found that a "10-percent increase in the minimum wage is associated with a 2.7-to-4.3 percent decline in teen employment in the retail sector, a 5-percent decline in average retail hours worked by all teenagers, and a 2.8-percent decline in retail hours worked by teenagers who remain employed in retail jobs."[12]

The effect is even greater on small businesses. Sabia found that a 10-percent increase in the minimum wage is associated with a 4.6-to-9.0-percent decline in teenage employment in small businesses, and a 4.8-to-8.8-percent reduction in hours worked by teens in the retail sector.[13] Another study by Professor Sabia and Cornell economic professor Richard Burkhauser estimated that a minimum wage hike to $7.25 an hour would add $18.3 billion in costs on mostly small and local businesses with typically thin profit margins.[14]

Views of the Commonwealth of the Northern Mariana Islands

In a letter dated June 13, 2006, Pedro A. Tenorio, Resident Representative of the Commonwealth of the Northern Mariana Islands (CNMI), wrote Senator Kennedy to express concern with applying the federal minimum wage to CNMI. In his letter, Mr. Tenorio notes that while he is "a proponent for an increase in our minimum wage as a step in creating opportunities for our young indigenous people to find jobs in the CNMI, I want this done in a rational and democratic manner."

Mr. Tenorio stated that the "CNMI's economy is on the verge of collapse. Unemployment is at 14%, the economy is down 23%, and this downward trend is showing no

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[9] Senator Phil Gramm (R-TX), *Congressional Record*, May 22, 2002.
[10] William Even and David Macpherson, "Rising Above the Minimum Wage," Employment Policies Institute, January 2000.
[11] Bureau of Labor Statistics, "Characteristics of Minimum Wage Workers: 2005," May 2006.
[12] Joseph J. Sabia, Professor of Consumer Economics at the University of Georgia, "The Effects of Minimum Wage Increases on Retail and Small Business Employment," May 2006. (available at www.epionline.org/studies/saba_05-2005.pdf)
[13] Sabia.
[14] Richard V. Burkhause and Josep J. Sabia, "Raising the Minimum Wage: Another Empty Promise to the Working Poor," written for the Employment Policies Institute, August2005. (available at www.epionline.org)

sign of reversing in the near future. An increase in our minimum wage implemented without economic considerations will surely destroy what is left of our fragile economy."

Bill Provisions

The following is a summary of H.R. 2, the Fair Minimum Wage Act of 2007.

Section 2 – Minimum Wage

Section 2 amends the Fair Labor Standards Act to:

- Raise the minimum wage to $5.85 an hour beginning on the 60th day after enactment;
- Raise the minimum wage to $6.55 an hour beginning 12 months after the first increase; and
- Raise the minimum wage to $7.25 an hour beginning 24 months after the first increase.

Section 3 – Applicability of Minimum Wage to the Commonwealth of the Northern Mariana Islands

Section 3 would apply Section 6 of the Fair Labor Standards Act (FLSA) to the Commonwealth of the Northern Mariana Islands. Section 6 of the FLSA speaks to the requirement to pay a minimum wage.

Section 3 provides for a transition from the current wage on the Commonwealth of the Northern Mariana Islands. The bill provides for an increase in the minimum wage to $3.55 an hour beginning on the 60th day after enactment. Subsequently, the minimum wage on the Commonwealth of the Northern Mariana Islands will increase 50-cents an hour beginning 6 months after enactment and every 6 months thereafter until the minimum wage on the Commonwealth of the Northern Mariana Island reaches the federal minimum wage level.

Today, January 22, Senator Reid on behalf of Senator Baucus offered a substitute amendment (SA 100) to H.R. 2. The substitute amendment contains the original language of H.R. 2, plus the small business tax package ordered reported from the Finance Committee on January 17, 2007. The provisions of the Baucus amendment, including the small business tax package are as follows (summaries provided by the Senate Finance Committee and the Joint Committee on Taxation):

Title I – Fair Minimum Wage

Section 101 – Minimum Wage

Section 101 amends the Fair Labor Standards Act to:

- Raise the minimum wage to $5.85 an hour beginning on the 60th day after enactment;
- Raise the minimum wage to $6.55 an hour beginning 12 months after the first increase; and
- Raise the minimum wage to $7.25 an hour beginning 24 months after the first increase.

Section 102 – Applicability of Minimum Wage to the Commonwealth of the Northern Mariana Islands

Section 102 would apply Section 6 of the Fair Labor Standards Act (FLSA) to the Commonwealth of the Northern Mariana Islands. Section 6 of the FLSA speaks to the requirement to pay a minimum wage.

Section 102 provides for a transition from the current wage on the Commonwealth of the Northern Mariana Islands. The bill provides for an increase in the minimum wage to $3.55 an hour beginning on the 60th day after enactment. Subsequently, the minimum wage on the Commonwealth of the Northern Mariana Islands will increase 50-cents an hour beginning 6 months after enactment and every 6 months thereafter until the minimum wage on the Commonwealth of the Northern Mariana Island reaches the federal minimum wage level.

Title II – Small Business Tax Relief Provisions

I. General Provisions

Section 201 – Section 179 Small Business Expensing

In lieu of depreciation, small business taxpayers may elect to deduct (or expense) the cost of qualified assets they purchase in the year when the assets are placed in service, within certain limits. Under the Jobs and Growth Tax Relief Reconciliation Act of 2003 (hereinafter "JGTRRA"), the amount that small businesses may expense under § 179 was increased from $25,000 to $100,000 for tax years beginning after 2002 through the end of 2005 (indexed for inflation). The American Jobs Creation Act of 2004 (hereinafter "AJCA") extended a slightly expanded version of small business expensing through 2007. The Tax Increase Prevention and

Reconciliation Act of 2005 (hereinafter "TIPRA") extended the provision through 2009. In tax year 2007, small business taxpayers are allowed to expense $112,000 (indexed for inflation), and the phase-out threshold is $450,000 (indexed for inflation). The *new* provision extends the present-law rules for one year, through the end of 2010, and is effective for taxable years beginning after December 31, 2009.

Section 202 – Fifteen-Year Straight-Line Cost Recovery for Qualified Leasehold Improvements and Qualified Restaurant Improvements

In the AJCA, Congress shortened the cost recovery of certain leasehold and restaurant improvements from 39 years to 15 years for the remainder of 2004 and 2005. The Tax Relief and Health Care Act of 2006 (hereinafter "TRHCA") extended this provision to property placed in service after December 31, 2005 through December 31, 2007. The *new* provision extends the present-law rules for qualified leasehold and restaurant improvements to March 31, 2008 and applies to property placed in service after December 31, 2007.

Fifteen-Year Straight-Line Cost Recovery for Qualified New Restaurant Buildings: Section 168(e)(3)(E)(v) currently provides a 15-year recovery period for qualified restaurant property placed in service before January 1, 2008. The *new* provision extends the 15-year recovery period for qualified restaurant improvements to new restaurant buildings. The provision generally applies to property placed in service after the date of enactment. Repeal of the three-year rule for restaurant property is effective for property placed in service after the date of enactment. The *new* provision expires on March 31, 2008.

Fifteen-Year Straight-Line Recovery for Qualified Retail Improvement Property: The *new* provision extends the 15-year recovery period for qualified leasehold improvements to improvements made by retailers who own their buildings. For purposes of the provision, qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building. In addition, retail establishments that qualify for the 15-year recovery period include those with a physical store front open to the general public in order to sell tangible personal property and/or services. The *new* provision applies to property placed in service after the date of enactment and expires on March 31, 2008.

Section 203 – Clarification of Cash Accounting Rules for Small Business

Current law says that the cash method of accounting may *not* be used by any C corporation, by any partnership that has a C corporation as a partner, or by any tax shelter. However, there are exceptions for farming businesses and qualified personal service corporations. Exceptions are also provided for C corporations and partnerships that have a C corporation as a partner if the average annual gross receipts in the three previous tax years do not exceed $5 million. The *new* provision permanently increases the threshold for the exception from $5 million to $10 million and indexes the threshold for inflation. This allowance would apply irrespective of whether inventories are maintained. The provision is applicable to taxable years beginning after the date of enactment.

<u>Section 204 – Work Opportunity Tax Credit (hereinafter “WOTC”)</u>

Under current law, WOTC allows employers credits against wages for hiring individuals from one or more of nine targeted groups. The *new* provision extends WOTC for five years for qualified individuals who begin work for an employer after December 31, 2007 and before January 1, 2013. The *new* provision expands the qualified veterans’ targeted group to include an individual who is certified as entitled to compensation for a service-connected disability incurred after September 10, 2001. In the case of individuals certified as entitled to compensation for a service-connected disability incurred after September 10, 2001, the *new* provision expands the definition of qualified first-year wages from $6,000 to $12,000. The *new* provision also expands the definition of high risk youths to include otherwise qualifying individuals age 18 but not yet age 40 on the hiring date. The other provisions are effective for individuals who begin work for an employer after the date of enactment in taxable years ending after such date.

<u>Section 205 – Treatment of Professional Employer Organizations (hereinafter “PEO”) as Employers</u>

The *new* provision creates a voluntary certification program for PEOs that meet standards of solvency and responsibility and that maintain ongoing certification by the IRS. Certified PEOs would have to accept sole liability for the collection of Federal employment taxes with respect to workers (“worksite employees”) performing services for PEO clients. Small or medium-sized businesses that contract with certified PEOs would be assured that they would not be liable for those taxes already paid to the PEO. The provision does <u>not</u> affect the determination of whether an employer-employee relationship exists for any purpose other than liability for payroll tax deposits. The provision is effective with respect to wages paid for services performed on or after January 1 of the first calendar year beginning more than 12 months after the date of the enactment of the provision. The Secretary of the Treasury is directed to establish the certification program for professional employer organizations not later than six months before the proposal becomes effective.

II. Subchapter S Provisions

<u>Section 211 – Capital Gain Not Treated as Passive Investment Income</u>

Under current law, an S corporation is subject to corporate level tax, at the highest corporate tax rate, on its excessive net passive income if the corporation has (1) accumulated earnings and profits at the close of the taxable year and (2) gross receipts more than 25 percent of which are passive investment income. The *new* provision eliminates gains from sales or exchanges of stock or securities as an item of passive investment. The provision applies to taxable years beginning after the date of enactment.

<u>Section 212 – Treatment of Bank Director Sales</u>

Under current law, an S corporation may have no more than 100 shareholders and may have only one outstanding class of stock. An S corporation has one class of stock *if* all outstanding share of stock confer identical rights to distribution and liquidation proceeds. Nation and state banking laws require that a director of a bank own stock. The *new* provision clarifies that qualifying director shares are <u>not</u> treated as a second class of stock for purposes of subchapter S. The provision applies to taxable years beginning after December 31, 2006.

<u>Section 213 – Treatment of Banks Changing from Reserve Method of Accounting</u>

Under current law, a financial institution which uses the reserve method of accounting for bad debts may <u>not</u> elect to be an S corporation. If a financial institution changes from the reserve method of accounting, there is taken into account for the taxable year of the change adjustments to taxable income necessary to prevent amounts from being duplicated or omitted by reason of change. These adjustments are subject to two levels of taxation. The *new* provision allows a bank which changes from the reserve method of accounting for bad debts to elect to take into account ALL adjustments the year before it changes to an S corporation. Adjustments taken into account the year before the corporation changes to an S corporation are only subject to corporate-level taxation. The *new* provision applies to taxable years beginning after December 31, 2007.

<u>Section 214 – Treatment of the Sale of Interest in a Qualified Subchapter S Subsidiary</u>

Under current law, an S corporation that owns all the stock of a corporation may elect to treat the subsidiary corporation as a qualified subchapter S subsidiary ("QSub"). A qualified subchapter S subsidiary is disregarded as a separate entity for Federal tax purposes and its items of income, deduction, loss and credit are treated as items of the S corporation. The *new* provision provides that where the disposition of stock of a QSub results in the termination of the QSub election, the disposition is treated as a disposition of an undivided interest in the assets of the QSub (based on the percentage of the stock disposed of) followed by a deemed transfer to the QSub in a transaction to which § 351 applies.

<u>Section 215 – Elimination of Earnings and Profits Attributable to Pre-1983 Years</u>

The *new* provision provides that in the case of any corporation which was not an S corporation for its first taxable year beginning after December 31, 1996, that the accumulated earnings and profits of the corporation as of the beginning of the first taxable year beginning after the date of the enactment of this provision is reduced by the accumulated earnings and profits (if any) accumulated in a taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S. The *new* provision applies to taxable years beginning after the date of enactment.

<u>Section 216 – Expansion of Qualifying Beneficiaries of an Electing Small Business Trust (hereinafter "ESBT")</u>

Under current law, an ESBT may be a shareholder of an S corporation. A nonresident alien may not be a shareholder of an S corporation, but may be a shareholder of a Limited Liability Corporation (hereinafter "LLC"). The *new* provision allows some parity between S corporations and LLCs by allowing nonresident aliens to become a qualified beneficiary of an ESBT that own S corporation stock. Please note that current law treatment of nonresident aliens as non-qualified shareholders of an S corporation does NOT change. The *new* provision is effective on the date of enactment.

Subtitle B — Revenue Provisions

Section 221 – Modification of Effective Date of Leasing Provisions of the American Jobs Creation Act of 2004

The *new* provision disallows future losses on foreign tax exempt use property for leases entered into, on, or before March 12, 2004. A provision in the American Jobs Creation Act applied to leases entered into after March 12, 2004. In a foreign Sale-In/Lease-Out (SILO) transaction, a foreign government or other foreign entity that doesn't pay U.S. tax "sells" property, such as a subway or sewer, to a U.S. taxable investor and then "leases" the property back for use. The effect is to transfer depreciation deductions from the tax-exempt entity, which cannot use the deductions, to a taxable entity that can, with little economic risk. The *new* provision is effective for taxable years beginning after December 31, 2006. The provision is estimated to raise $4.273 billion over five years and $4.088 billion over ten years.

Section 222 – Corporate Inversions

The *new* provision revises the corporate inversion effective date of section 7874 of the American Jobs Creation Act (AJCA) from the AJCA date of March 4, 2003 to March 20, 2002. Section 7874 was enacted to stop U.S. corporations and partnerships from using inversion transactions to escape U.S. tax on their earnings. Section 7874 applies to two types of inversion transactions that occurred after March 4, 2003. In the first type of transaction, a U.S. corporation becomes a subsidiary of a foreign-incorporated entity and the former shareholders of the U.S. corporation own 80 percent or more of the foreign-incorporated entity (an "80-percent inversion'). These foreign-incorporated entities are treated as U.S. corporations for all U.S. income tax purposes. In the second type of transaction, former shareholders of the U.S. corporation own 60 percent or more, but less than 80 percent, of the foreign-incorporated entity. In these transactions, the foreign-incorporated entity is treated as foreign, but any applicable corporate-level "toll-charge" taxes are not offset by tax attributes such as net operating losses or foreign tax credits. Section 7874 also applies inversion transactions involving certain partnerships. An exception applies for transactions that were substantially completed prior to March 4, 2003. Under this provision section 7874 would apply to treat foreign corporations as U.S. corporations if they completed an 80-percent inversion after March 20, 2002 but on or before March 4, 2003, subject to the same exception for substantially completed transactions that is contained in present law. The provision is effective for tax years beginning after December 31, 2006. It is estimated to raise $449 million over five years and $1.153 billion over ten years.

Section 223 – Deny Deduction for Punitive Damages

The *new* provision eliminates the deduction for punitive damages, including torts that are paid or incurred by the taxpayer as a result of a judgment or in settlement of a claim. Payments made by insurance companies for punitive damages are included in the gross income of the insured person and the insurer is required to report the amount paid to both the insured person and the IRS. The proposal is effective for punitive damages that are paid or incurred on or after the date of enactment. The *new* provision is estimated to raise $130 million over five years and $299 million over ten years.

Section 224 – Denial of Deduction for Certain Fines, Penalties, and Other Amounts

The *new* provision clarifies that amounts paid or incurred in connection with civil settlements to or at the direction of a government for the violation of any law or the potential violation of law are not deductible for Federal income tax purposes. Amounts for restitution or remediation are deductible. Government agencies are required to notify the IRS of settlements. The *new* provision would be effective for amounts paid or incurred on or after the date of enactment unless paid under a binding order or agreement entered before that date. The *new* provision is estimated to raise $172 million over five years and $244 million over ten years.

Section 225 – Impose Mark-to-Market on Individuals Who Expatriate

The *new* provision applies to certain U.S. citizens who relinquish their U.S. citizenship and certain long-term residents who terminate their U.S. residency, and generally taxes these individuals on the net unrealized gain in their property as if such property were sold for fair market value. 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), and it is taken into account at the time of expatriation without regard to other tax code provisions. Any loss from the deemed sale generally is taken into account to the extent otherwise provided in the tax code. In addition, the exclusion from income for the value of property acquired by gift or inheritance does not apply to the value of any property received from a covered expatriate. The new provision is generally effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after the date of enactment. The *new* provision is estimated to raise $220 million over five years and $417 million over ten years.

Section 226 – Deferred Compensation

The annual deferral on behalf of an individual to nonqualified deferred compensation arrangements of an employer is limited to the lesser of $1 million or the average taxable compensation for the previous five years. Failure to comply will result in ordinary income tax and the penalties applicable to other failures to comply with deferral rules. The *new* provision applies to taxable years beginning after December 31, 2006; however, earlier years will be taken into account for purposes of computing the five-year average. The *new* provision is estimated to raise $307 million over five years and $806 million over ten years.

Section 227 – Increase in Certain Criminal Penalties

The *new* provision increases the criminal penalties for tax evasion and failure to file. It also institutes an “aggravated” failure to file penalty that is a felony when there is a failure to file for at least three years. It applies to actions and failures to act after the date of enactment. The *new* provision is estimated to raise $1 million over five years and $5 million over ten years.

Section 228 – Doubling of Certain Penalties, Fines, and Interest on Underpayments Related to Certain Offshore Financial Arrangements

The *new* provision doubles the amounts of civil penalties, interest, and fines related to taxpayers' underpayments of U.S. income tax liability through the direct or indirect use of certain offshore financial arrangements. The change applies to taxpayers who did not voluntarily disclose such arrangements through the IRS Offshore Voluntary Compliance Initiative, or who do not otherwise disclose. The provision applies to open tax years on or after the date of enactment. The *new* provision is estimated to raise $5 million over five years and $10 million over ten years.

Section 229 – Increase in Penalty for Bad Checks and Money Orders

For bad checks or money orders paid to the IRS of less than $1,250, the penalty is raised to the lesser of $25 or the amount of the check or money order. This is an increase from the current threshold of less than $750 and $15. For amounts of $1,250 or more, the penalty remains at 2 percent of the check amount. It is effective on checks or money orders received on or after the date of enactment. The *new* provision is estimated to raise $10 million over five years and $20 million over ten years.

Section 230 – Modify the Tax Treatment of Contingent Payment Convertible Debt Instruments

The *new* provision creates a consistent "apples to apples" approach to value contingent convertible debt for purposes of computing original issue discount (OID). A "comparable rate" for a contingent convertible debt instrument would be based on a non-contingent, convertible debt instrument (instead of a non-convertible debt instrument, as the IRS now applies the law). It is effective for debt instruments issued on or after the date of enactment. The *new* provision is estimated to raise $222 million over five years and $448 million over ten years.

Section 231 – Extension of IRS User Fees

The *new* provision extends the statutory authorization of the IRS to impose user fees for two additional years, through 9/30/16. The authorization was extended through 2014 in the American Jobs Creation Act. The *new* provision is effective for requests after September 30, 2014. It is estimated to raise $60 million over ten years.

Section 232 – Amend Collection Due Process Procedures for Employment Tax Liabilities

Levy is the IRS's administrative authority to seize a taxpayer's property to pay the taxpayer's tax liability. The IRS is required to notify taxpayers that they have a right to a fair and impartial collection due process ("CDP") hearing before levy may be made on any property or right to property. Under the proposal, levies issued to collect Federal employment taxes are excepted from the pre-levy CDP hearing requirement. Taxpayers have full rights after the CDP hearing. The new provision applies to levies issued on or after 120 days after the date of enactment. The *new* provision is estimated to raise $156 million over five years and $271 million over ten years.

Section 233 – Whistleblower Reforms

The Code currently authorizes the IRS to pay reward money for information received from whistleblowers. The reward amount varies based on the type of information and the amount of proceeds actually collected. The proposal expands whistleblower reforms enacted in H.R. 6408, the Tax Relief and Health Care Act of 2006, by requiring the establishment of a Whistleblower Office that is responsible for monitoring information received from informants and determining amounts to be awarded. It applies to deficiencies exceeding $20,000 and, in the case of individuals, incomes exceeding $200,000. This provision applies to information provided on or after the date of enactment. The *new* provision raises $77 million over five years and $402 million over ten years.

Section 234 – Modify Definition of Covered Employee

The provision modifies the definition of a covered employee to include: (1) any individual who was the Chief Executive Officer of the company at any time during the taxable year; (2) the four officers with the highest compensation for the year; and (3) any individual who was previously a covered employee with respect to the company (or a beneficiary of such person). The *new* provision is effective for taxable years beginning after December 31, 2006 and is estimated to raise $20 million over five years and $105 million over ten years.

Cost

Although the Congressional Budget Office (CBO) has not released a cost estimate on the substitute amendment to H.R. 2 at press time, a cost estimate was issued on H.R. 2 as it came before the House.[15] According to CBO, while it estimates that enacting H.R. 2 would have no significant effects on the federal budget, "the costs of state, local, and tribal governments would exceed the threshold established by UMRA [Unfunded Mandates Reform Act] for intergovernmental mandates…in each year beginning in fiscal year 2008."[16] Preemption of the minimum wage laws in the CNMI is also considered a mandate.

CBO also estimates that the costs to the private sector would exceed the annual threshold established for private-sector mandates under UMRA beginning in fiscal year 2007.[17]

The following table from CBO summarizes the estimated costs of House-passed version of H.R. 2:

[15] Congressional Budget Office, "Cost Estimate of H.R. 2, Fair Minimum Wage Act of 2007," January 11, 2007. [http://www.cbo.gov/ftpdocs/77xx/doc7726/hr2.pdf]
[16] CBO.
[17] CBO.

Estimated Costs of Mandates in H.R. 2

	By Fiscal Year, in Billions of Dollars				
	2007	2008	2009	2010	2011
Costs to State, Local and Tribal Governments					
Increase the federal minimum wage	*	0.1	0.2	0.3	0.4
Direct Cost to the Private Sector					
Increase the federal minimum wage	0.3	1.5	4.0	5.7	5.0
Apply the minimum wage to the CNMI	*	0.1	0.1	0.2	0.2

Note: * = Less than $50 million.

The Joint Committee on Taxation estimated that the small business tax package reported out of the Senate Finance Committee would result in an overall revenue gain of $21 million over 10 years. For a copy of JCT's revenue estimate of H.R.2, please see http://www.senate.gov/~finance/press/Gpress/2007/prg011207lega.pdf. The overall cost of the Reid/Baucus substitute to H.R. 2 was not available at press time.

Administration Position

The Administration released its Statement of Administration Policy on January 22, 2007. It reads as follows:

The Administration supports Senate passage of legislation which increases the minimum wage by $2.10 over two years and pairs it with tax relief for small businesses, which are creating most of the new jobs in the United States. Such an approach will help maintain a strong and flexible labor market, assisting both workers and small businesses.

The Administration appreciates the Senate Finance Committee's willingness to respond in a bipartisan fashion to the President's call to enact a minimum wage increase matched with tax relief for small businesses. The Administration does not think it is necessary to tie this small business tax relief to other revenue increases.

Possible Amendments

The full scope of amendments it is not known at press time. In addition to the Baucus substitute and the McConnell/Gregg amendments already offered, it is expected that numerous amendments will be offered from both sides. Anticipated amendments include:

- a Martinez amendment to address a wage inconsistency for houseparents at residential, educational facilities for foster children and emotionally-scarred youth;
- a Roberts amendment to authorize a $50 million (over 5 years) Small Business Child Care Grant Program, a flexible grant program to encourage small businesses to work together or with other local child care agencies to provide child care services for employees;
- a Snowe/Enzi amendment to clarify and enhance the small business compliance assistance requirements of the Small Business Regulatory Enforcement Fairness Act of 1996;
- an amendment modifying the minimum wage in the American Samoa;
- a Gregg amendment (similar to a provision included in the previous Santorum and Enzi minimum wage alternatives) to give private-sector employers and employees the option to enter voluntarily into arrangements to permit employees to "flex" up to 10 hours of work over a two-week period, without the employer incurring an overtime penalty;
- an amendment to permit states to "opt-out" of the increased minimum wage, and instead choose to stay at the current federal minimum wage of $5.15 an hour;
- an Ensign amendment to the Social Security Act to ensure that illegal immigrants cannot collect Social Security benefits for illegal work;
- an Ensign amendment to change the way that Social Security Totalization agreements are approved; would require that both Houses of Congress must approve the agreement before it can go into effect (current law says they automatically go into effect within 60 days);
- an Ensign amendment to allow the Secretary of Labor to temporarily suspend the minimum wage in areas under a Stafford Act disaster declaration;
- an Ensign amendment to improve access to health care for individuals and families who purchase health insurance in the individual market by permitting individuals and families who purchase a high-deductible health plan in the individual market to use HSA dollars to pay plan premiums;
- an amendment to extend the leasehold improvements, new restaurant construction, and retail improvements tax credits through December 31, 2008 (the abovementioned tax provisions in the Baucus substitute amendment expire on March 31, 2008);
- a Sessions amendment to increase civil and criminal employer sanctions with regard to the current I-9 employment verification system; provide an affirmative defense against civil and criminal sanctions for employers if they voluntarily participate in the current basic pilot Electronic Employment Verification System and use it to check all employees, not just future hires; and change the current pilot program to permit employers to use the system to check the status of all current employees, not just future hires;

- a Sessions amendment to ban any current government contractor found to employ illegal aliens for 10 years; a ban of 7 years for any companies not currently holding government contracts found employing illegal aliens; and an exigent-circumstances exception allowing the U.S. government to waive the ban on contracts if the waiver is needed for national defense or national security purposes;
- a DeMint amendment seeking to apply the minimum wage increase equally to all states; the amendment would increase the minimum wage in each state by $2.10 an hour;
- a DeMint amendment to allow individuals to purchase health insurance across state lines, permit $500 to be rolled-over annually in flexible spending accounts, and permit health savings accounts funds to be used to pay for health insurance premiums;
- a DeMint amendment to require unions to seek prior, written and voluntary authorization from an individual before they can collect money from the individual to be used to lobby members of Congress or Congressional staff;
- a DeMint amendment to permit a $500 annual roll-over in flexible spending accounts to become effective in FY 2011;
- a DeMint amendment to increase the small business threshold for application of the Fair Labor Standards Act to $1 million from its current level of $500,000, which has not been updated since 1989;
- a DeMint amendment to defer the payment of federal corporate taxes for small, high-growth businesses for 2 years, and to be repaid over the subsequent 4 years;
- a Burr amendment to permit employers the option to provide employees the $2.10 an hour increase in wages *or* toward health care benefits;
- a Sununu amendment to reduce the paperwork requirements for public housing authorities with 500 or fewer housing units (and any number of vouchers) from the requirement of submitting an annual plan to the Department of Housing and Urban Development.

<u>Budget Point of Order:</u> The bill *may* be subject to one or more budget points of order. Sixty votes are necessary to waive a budget point of order.

One potential budget point of order is related to the fact that, according to CBO, the measure would impose an unfunded mandate on some state and local governments, and Indian tribes by requiring them to pay higher wages than they are required to pay under existing law.

Another potential budget point of order relates to section 407, which provides for a point of order for any spending greater than $5 billion in any ten-year period in the future. This point of order would be relevant to the Baucus substitute, which contains the small business package.

As information becomes available about the likelihood of additional amendments such as those above, the RPC will circulate amendment summaries to Republican staff. Please note that if cloture is invoked on the underlying bill, all remaining amendments must be germane.