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REPORT
112–425

SMALL BUSINESS TAX CUT ACT

APRIL 10, 2012.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. CAMP, from the Committee on Ways and Means, submitted the following

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 9]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 9) to amend the Internal Revenue Code of 1986 to provide a deduction for domestic business income of qualified small businesses, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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AMENDMENT

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Small Business Tax Cut Act”.

19–006

SEC. 2. DEDUCTION FOR DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES.

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 of the Internal Revenue Code of 1986 is amended by adding at the end the following new section:

"SEC. 200. DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES.

"(a) ALLOWANCE OF DEDUCTION.—In the case of a qualified small business, there shall be allowed as a deduction an amount equal to 20 percent of the lesser of—

"(1) the qualified domestic business income of the taxpayer for the taxable year, or

"(2) taxable income (determined without regard to this section) for the taxable year.

"(b) DEDUCTION LIMITED BASED ON WAGES PAID.—

"(1) IN GENERAL.—The amount of the deduction allowable under subsection (a) for any taxable year shall not exceed 50 percent of the greater of—

"(A) the W–2 wages of the taxpayer paid to non-owners, or

"(B) the sum of—

"(i) the W–2 wages of the taxpayer paid to individuals who are non-owner family members of direct owners, plus

"(ii) any W–2 wages of the taxpayer paid to 10-percent-or-less direct owners.

"(2) DEFINITIONS RELATED TO OWNERSHIP.—For purposes of this section—

"(A) NON-OWNER.—The term 'non-owner' means, with respect to any qualified small business, any person who does not own (and is not considered as owning within the meaning of subsection (c) or (e)(3) of section 267, as the case may be) any stock of such business (or, if such business is other than a corporation, any capital or profits interest of such business).

"(B) NON-OWNER FAMILY MEMBERS.—An individual is a non-owner family member of a direct owner if—

"(i) such individual is family (within the meaning of section 267(c)(4)) of a direct owner, and

"(ii) such individual would be a non-owner if subsections (c) and (e)(3) of section 267 were applied without regard to section 267(c)(2).

"(C) DIRECT OWNER.—The term 'direct owner' means, with respect to any qualified small business, any person who owns (or is considered as owning under the applicable non-family attribution rules) any stock of such business (or, if such business is other than a corporation, any capital or profits interest of such business).

"(D) 10-PERCENT-OR-LESS DIRECT OWNERS.—The term '10-percent-or-less direct owner' means, with respect to any qualified small business, any direct owner of such business who owns (or is considered as owning under the applicable non-family attribution rules)—

"(i) in the case of a qualified small business which is a corporation, not more than 10 percent of the outstanding stock of the corporation or stock possessing more than 10 percent of the total combined voting power of all stock of the corporation, or

"(ii) in the case of a qualified small business which is not a corporation, not more than 10 percent of the capital or profits interest of such business.

"(E) APPLICABLE NON-FAMILY ATTRIBUTION RULES.—The term 'applicable non-family attribution rules' means the attribution rules of subsection (c) or (e)(3) of section 267, as the case may be, but in each case applied without regard to section 267(c)(2).

"(3) W–2 WAGES.—For purposes of this section—

"(A) IN GENERAL.—The term 'W–2 wages' means, with respect to any person for any taxable year of such person, the sum of the amounts described in paragraphs (3) and (8) of section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

"(B) LIMITATION TO WAGES ATTRIBUTABLE TO QUALIFIED DOMESTIC BUSINESS INCOME.—Such term shall not include any amount which is not properly allocable to domestic business gross receipts for purposes of subsection (c)(1).

"(C) OTHER REQUIREMENTS.—Except in the case of amounts treated as W–2 wages under paragraph (4)—

"(i) such term shall not include any amount which is not allowed as a deduction under section 162 for the taxable year, and

"(ii) such term shall not include any amount which is not properly included in a return filed with the Social Security Administration on

or before the 60th day after the due date (including extensions) for such return.

"(4) CERTAIN PARTNERSHIP DISTRIBUTIONS TREATED AS W–2 WAGES.—

"(A) IN GENERAL.—In the case of a qualified small business which is a partnership and elects the application of this paragraph for the taxable year—

"(i) the qualified domestic business taxable income of such partnership for such taxable year (determined after the application of clause (ii)) which is allocable under rules similar to the rules of section 199(d)(1)(A)(ii) to each qualified service-providing partner shall be treated for purposes of this section as W–2 wages paid during such taxable year to such partner as an employee, and

"(ii) the domestic business gross receipts of such partnership for such taxable year shall be reduced by the amount so treated.

"(B) QUALIFIED SERVICE-PROVIDING PARTNER.—For purposes of this paragraph, the term 'qualified service-providing partner' means, with respect to any qualified domestic business taxable income, any partner who is a 10-percent-or-less direct owner and who materially participates in the trade or business to which such income relates.

"(5) ACQUISITIONS AND DISPOSITIONS.—The Secretary shall provide for the application of this subsection in cases where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

"(c) QUALIFIED DOMESTIC BUSINESS INCOME.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified domestic business income' for any taxable year means an amount equal to the excess (if any) of—

"(A) the taxpayer's domestic business gross receipts for such taxable year, over

"(B) the sum of—

"(i) the cost of goods sold that are allocable to such receipts, and

"(ii) other expenses, losses, or deductions (other than the deduction allowed under this section), which are properly allocable to such receipts.

"(2) DOMESTIC BUSINESS GROSS RECEIPTS.—

"(A) IN GENERAL.—The term 'domestic business gross receipts' means the gross receipts of the taxpayer which are effectively connected with the conduct of a trade or business within the United States within the meaning of section 864(c) but determined—

"(i) without regard to paragraphs (3), (4), and (5) thereof, and

"(ii) by substituting 'qualified small business (within the meaning of section 200)' for 'nonresident alien individual or a foreign corporation' each place it appears therein.

"(B) EXCEPTIONS.—For purposes of paragraph (1), domestic business gross receipts shall not include any of the following:

"(i) Gross receipts derived from the sale or exchange of—

"(I) a capital asset, or

"(II) property used in the trade or business (as defined in section 1231(b)).

"(ii) Royalties, rents, dividends, interest, or annuities.

"(iii) Any amount which constitutes wages (as defined in section 3401).

"(3) APPLICATION OF CERTAIN RULES.—Rules similar to the rules of paragraphs (2) and (3) of section 199(c) shall apply for purposes of this section (applied with respect to qualified domestic business income in lieu of qualified production activities income and with respect to domestic business gross receipts in lieu of domestic production gross receipts).

"(d) QUALIFIED SMALL BUSINESS.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified small business' means any employer engaged in a trade or business if such employer had fewer than 500 full-time equivalent employees for either calendar year 2010 or 2011.

"(2) FULL-TIME EQUIVALENT EMPLOYEES.—The term 'full-time equivalent employees' has the meaning given such term by subsection (d)(2) of section 45R applied—

"(A) without regard to subsection (d)(5) of such section,

"(B) with regard to subsection (e)(1) of such section, and

"(C) by substituting 'calendar year' for 'taxable year' each place it appears therein.

"(3) EMPLOYERS NOT IN EXISTENCE PRIOR TO 2012.—In the case of an employer which was not in existence on January 1, 2012, the determination under paragraph (1) shall be made with respect to calendar year 2012.

"(4) APPLICATION TO CALENDAR YEARS IN WHICH EMPLOYER IN EXISTENCE FOR PORTION OF CALENDAR YEAR.—In the case of any calendar year during which the employer comes into existence, the number of full-time equivalent employees determined under paragraph (2) with respect to such calendar year shall be increased by multiplying the number so determined (without regard to this paragraph) by the quotient obtained by dividing—

"(A) the number of days in such calendar year, by

"(B) the number of days during such calendar year which such employer is in existence.

"(5) SPECIAL RULES.—

"(A) AGGREGATION RULE.—For purposes of paragraph (1), any person treated as a single employer under subsection (a) or (b) of section 52 (applied without regard to section 1563(b)) or subsection (m) or (o) of section 414 shall be treated as a single employer for purposes of this subsection.

"(B) PREDECESSORS.—Any reference in this subsection to an employer shall include a reference to any predecessor of such employer.

"(e) SPECIAL RULES.—

"(1) ELECTIVE APPLICATION OF DEDUCTION.—Except as otherwise provided by the Secretary, the taxpayer may elect not to take any item of income into account as domestic business gross receipts for purposes of this section.

"(2) COORDINATION WITH SECTION 199.—If a deduction is allowed under this section with respect to any taxpayer for any taxable year—

"(A) any gross receipts of the taxpayer which are taken into account under this section for such taxable year shall not be taken into account under section 199 for such taxable year, and

"(B) the W–2 wages of the taxpayer which are taken into account under this section shall not be taken into account under section 199 for such taxable year.

"(3) APPLICATION OF CERTAIN RULES.—Rules similar to the rules of paragraphs (1), (2), (3), (4), (6), and (7) of section 199(d) shall apply for purposes of this section (applied with respect to qualified domestic business income in lieu of qualified production activities income).

"(f) REGULATIONS.—The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section, including regulations which prevent a taxpayer which reorganizes from being treated as a qualified small business if such taxpayer would not have been treated as a qualified small business prior to such reorganization.

"(g) APPLICATION.—Subsection (a) shall apply only with respect to the first taxable year of the taxpayer beginning after December 31, 2011.".

(b) CONFORMING AMENDMENTS.—

(1) Section 56(d)(1)(A) of such Code is amended by striking "deduction under section 199" both places it appears and inserting "deductions under sections 199 and 200".

(2) Section 56(g)(4)(C) of such Code is amended by adding at the end the following new clause:

"(vii) DEDUCTION FOR DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES.—Clause (i) shall not apply to any amount allowable as a deduction under section 200.".

(3) The following provisions of such Code are each amended by inserting "200," after "199,".

(A) Section 86(b)(2)(A).

(B) Section 135(c)(4)(A).

(C) Section 137(b)(3)(A).

(D) Section 219(g)(3)(A)(ii).

(E) Section 221(b)(2)(C)(i).

(F) Section 222(b)(2)(C)(i).

(G) Section 246(b)(1).

(H) Section 469(i)(3)(F)(iii).

(4) Section 163(j)(6)(A)(i) of such Code is amended by striking "and" at the end of subclause (III) and by inserting after subclause (IV) the following new subclause:

"(V) any deduction allowable under section 200, and".

(5) Section 170(b)(2)(C) of such Code is amended by striking "and" at the end of clause (iv), by striking the period at the end of clause (v) and inserting ", and", and by inserting after clause (v) the following new clause:

"(vi) section 200.".

(6) Section 172(d) of such Code is amended by adding at the end the following new paragraph:

"(8) DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES.—The deduction under section 200 shall not be allowed.".

(7) Section 613(a) of such Code is amended by striking "deduction under section 199" and inserting "deductions under sections 199 and 200".

(8) Section 613A(d)(1) of such Code is amended by redesignating subparagraphs (C), (D), and (E) as subparagraphs (D), (E), and (F), respectively, and by inserting after subparagraph (B) the following new subparagraph:

"(C) any deduction allowable under section 200,".

(9) Section 1402(a) of such Code is amended by striking "and" at the end of paragraph (16), by redesignating paragraph (17) as paragraph (18), and by inserting after paragraph (16) the following new paragraph:

"(17) the deduction provided by section 200 shall not be allowed; and".

(c) CLERICAL AMENDMENT.—The table of sections for part VI of subchapter B of chapter 1 of such Code is amended by adding at the end the following new item:

"Sec. 200. Domestic business income of qualified small businesses.".

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

The bill, H.R. 9, reported by the Committee on Ways and Means, provides, in the case of a qualified small business for the first taxable year beginning in 2012, a deduction for 20 percent of the qualified domestic business income of the taxpayer for the taxable year, or taxable income for the taxable year, whichever is less. However, a taxpayer's deduction for any taxable year may not exceed 50 percent of certain W–2 wages of the qualified small business.

B. BACKGROUND AND NEED FOR LEGISLATION

While the Committee continues to actively pursue comprehensive tax reform as a critical means of promoting economic growth and job creation, the Committee also believes that it is important to provide small businesses meaningful, immediate tax relief in order to help put more Americans back to work right away. With the Nation's unemployment rate having now remained above eight percent for more than three years, it is critical that Congress help struggling small businesses hire new employees and increase wages. By providing all qualified small businesses with fewer than 500 employees—regardless of whether they are organized as pass-through businesses (S corporations or partnerships), sole proprietorships, or C corporations—a 20-percent deduction against active business income, H.R. 9 would help free up additional resources allowing small businesses to create more jobs in communities across the country.

C. LEGISLATIVE HISTORY

Background

H.R. 9 was introduced on March 21, 2012, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up H.R. 9, the Small Business Tax Cut Act, on March 28, 2012, and ordered the bill, as amended, favorably reported (with a quorum being present).

Committee hearings

The proposed 20-percent deduction for small businesses has been discussed at several Committee hearings during the 112th Congress, including at the Select Revenue Measures Subcommittee's March 3, 2011, hearing on "Small Businesses and Tax Reform" and at the Committee's March 7, 2012, hearing on "The Treatment of Closely-Held Businesses in the Context of Tax Reform." While the general context for those particular hearings was the need for broader comprehensive tax reform, discrete legislative proposals affecting small businesses—such as the 20-percent small business deduction embodied in H.R. 9—were explored by Committee Members and witnesses at those hearings as well.

II. EXPLANATION OF THE BILL

A. TWENTY-PERCENT DEDUCTION FOR DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESS (SEC. 2 OF THE BILL AND NEW SEC. 200 OF THE CODE)

PRESENT LAW

C corporations

A C corporation[1] is subject to Federal income tax as an entity separate from its shareholders. A C corporation's income generally is taxed when earned at the corporate level and is taxed again at the individual level when distributed as dividends[2] to its shareholders. Corporate deductions and credits reduce only corporate income (and corporate income taxes) and are not passed directly through to shareholders.

Tax rates for C corporations

C corporations are taxed at statutory rates ranging from 15 percent (for taxable income up to $50,000) to 35 percent (for taxable income over $10,000,000); the intermediate rates are 25 percent (for taxable income above $50,000 but not exceeding $75,000) and 34 percent (for taxable income above $75,000 but not exceeding $10,000,000).[3] The benefit of graduated rates below 34 percent is phased out for C corporations with taxable income between $100,000 and $335,000, and the benefit of the 34 percent rate is phased out for C corporations with taxable income in excess of $15,000,000. C corporation long-term capital gains are taxed at the same rates as C corporation ordinary income. Thus, the maximum tax rate for C corporation net long-term capital gains is 35 percent.

A C corporation is subject to an alternative minimum tax that is payable, in addition to all other tax liabilities, to the extent that it exceeds the C corporation's regular income tax liability. The tax is imposed at a flat rate of 20 percent on alternative minimum tax-

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[1] A C corporation is so named because its Federal tax treatment is governed by subchapter C of the Internal Revenue Code of 1986, as amended (the "Code").

[2] Distributions with respect to stock that exceed corporate earnings and profits are not taxed as dividend income to shareholders but are treated as a tax-free return of capital that reduces the shareholder's basis in the stock. Distributions in excess of corporate earnings and profits that exceed a shareholder's basis in the stock are treated as amounts received in exchange for the stock which, in general, are taxed to the shareholder at capital gains rates. Sec. 301(c).

[3] Sec. 11.

able income ("AMTI") in excess of a $40,000 exemption amount.[4] Certain credits that are allowed to offset a C corporation's regular tax liability generally are not allowed to offset its minimum tax liability. If a C corporation pays the alternative minimum tax, the amount of the tax paid is allowed as a credit against the regular tax in future years to the extent the regular tax exceeds the tentative minimum tax. Small C corporations meeting a gross receipts test are exempt from the corporate alternative minimum tax. Generally, a C corporation meets the gross receipts test if its average annual gross receipts for the prior three taxable years do not exceed $7.5 million.

Passthrough entities

S corporations

An S corporation[5] generally is not subject to corporate tax on its income.[6] Instead, S corporation shareholders include in income their pro rata shares of the S corporation's items of income (including tax-exempt income), gain, loss, deduction, credit, and nonseparately computed income or loss, whether or not distributed.[7] To be eligible to elect S corporation status, a corporation may not have more than 100 shareholders and may not have more than one class of stock.[8] Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders. A corporation may elect S corporation status only with the consent of all its shareholders, and may terminate its election with the consent of shareholders holding more than 50 percent of the stock.[9]

Partnerships

Partnerships generally are treated for Federal income tax purposes as passthrough entities, not subject to tax at the entity level.[10] Items of income (including tax-exempt income), gain, loss, deduction, and credit of the partnership are taken into account in computing the tax of the partners (based on the partnership's method of accounting and regardless of whether the income is distributed to the partners).[11] A partner's deduction for partnership losses is limited to the amount of the partner's adjusted basis in his or her partnership interest.[12] To the extent a loss is not allowed due to a limitation, it generally is carried forward to the next year.

TAX RATES FOR INDIVIDUALS

U.S. individuals (citizens and residents) are taxed at graduated statutory rates ranging from 10 percent (for taxable income of up to $8,700 for single filers and up to $17,400 for married taxpayers

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[4] The exemption amount is phased out for corporations with income above certain thresholds, and is completely phased out for corporations with alternative minimum taxable income of $310,000 or more.

[5] An S corporation is so named because its Federal tax treatment is governed by subchapter S of the Code.

[6] Sec. 1363.

[7] Sec. 1366.

[8] Sec. 1361. For this purpose, a husband and wife and all members of a family are treated as one shareholder. Sec. 1361(c)(1).

[9] Sec. 1362.

[10] Sec. 701.

[11] Sec. 702(a).

[12] Sec. 704(d).

filing joint returns or surviving spouses) to 35 percent (for taxable income over $388,350) for taxable year 2012; the intermediate rates are 15 percent, 25 percent, 28 percent, and 33 percent.[13] The maximum tax rate on net long-term capital gains generally is 15 percent.[14] Dividends received by an individual from domestic corporations and qualified foreign corporations are taxed at the same rates that apply to capital gains.[15] For 2013, the statutory rates range from 15 percent to 39.6 percent, and the maximum tax rate on net long-term capital gains generally is 20 percent (other than collectibles or unrecaptured section 1250 property).

An alternative minimum tax is imposed on an individual in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. The tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the AMTI as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the taxpayer's taxable income increased by the taxpayer's tax preferences and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The exemption amounts are: (1) $45,000 in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 in the case of other unmarried individuals; and (3) $22,500 in the case of married individuals filing separate returns. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns. These amounts are not indexed for inflation.

Section 199 deduction

In general

Certain domestic production activities are effectively taxed at lower rates by virtue of a deduction equal to a percentage of the income from such activities.[16] The deduction is equal to nine percent of the lesser of income from manufacturing, construction, and certain other activities specified in the statute (collectively, qualified production activities income), or taxable income.[17] Thus, gen-

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[13] Secs. 1(a), (c) and (i).

[14] Sec. 1(h). Net gain from the sale of collectibles is taxed at a maximum 28 percent rate, while certain gain from the sale or exchange of depreciable real estate ("unrecaptured section 1250 property") is taxed at a maximum 25 percent rate. Under present law, for taxable years beginning after 2012, the maximum tax rate applicable to net long-term capital gains (other than collectibles or unrecaptured section 1250 property) increases from 15 percent to 20 percent.

[15] Sec. 1(h)(11). Under present law, for taxable years beginning after 2012, dividends received by an individual are taxed at ordinary income rates.

[16] Sec. 199.

[17] However, for taxpayers that have qualified income related to the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof (collectively, "oil related production activities income"), the deduction is limited to six percent of its oil related production activities income. Sec. 199(d)(9).

erally the maximum tax rate for a C corporation on its domestic production activities income is effectively 31.85 percent.[18]

However, a taxpayer's deduction under section 199 for a taxable year may not exceed 50 percent of the wages properly allocable to domestic production gross receipts paid by the taxpayer during the calendar year that ends in such taxable year.[19]

Qualified production activities income

In general, qualified production activities income is equal to domestic production gross receipts, reduced by the sum of: (1) the costs of goods sold that are allocable to such receipts;[20] (2) other deductions, expenses, or losses that are directly allocable to such receipts; and (3) a proper share of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income.[21]

Domestic production gross receipts

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States;[22] (2) any sale, exchange or other disposition, or any lease, rental, or license, of qualified film produced by the taxpayer; (3) any sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4)

[18] In the case of corporate taxpayers that are members of certain affiliated groups, the deduction is determined by treating all members of such groups as a single taxpayer and the deduction is allocated among such members in proportion to each member's respective amount (if any) of qualified production activities income. Members of an expanded affiliated group for purposes of the provision generally include those corporations which would be members of an affiliated group if such membership were determined based on an ownership threshold of "more than 50 percent" rather than "at least 80 percent."

[19] For purposes of the provision, wages include the sum of the amounts of wages as defined in section 3401(a) (*i.e.*, wages subject to income tax withholding) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and, for taxable years beginning after December 31, 2005, designated roth contributions (as defined in section 402A).

[20] For purposes of determining such costs, any item or service that is imported into the United States without an arm's length transfer price is treated as acquired by purchase, and its cost shall be treated as not less than its value when it entered the United States. A similar rule applies in determining the adjusted basis of leased or rented property where the lease or rental gives rise to domestic production gross receipts. With regard to property previously exported by the taxpayer for further manufacture, the increase in cost or adjusted basis may not exceed the difference between the value of the property when exported and the value of the property when re-imported into the United States after further manufacture. Except as provided by the Secretary, the value of property for this purpose is its customs value (as defined in section 1059A(b)(1)).

[21] See Treas. Reg. secs. 1.199–1 through 1.199–9 prescribing rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining qualified production activities income. Where appropriate, such rules are similar to and consistent with relevant present-law rules (e.g., sec. 263A, in determining the cost of goods sold, and sec. 861, in determining the source of such items). Other deductions, expenses or losses that are directly allocable to such receipts include, for example, selling and marketing expenses. A proper share of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income include, for example, general and administrative expenses allocable to selling and marketing expenses. In computing qualified production activities income, the domestic production activities deduction itself is not an allocable deduction.

[22] Domestic production gross receipts include gross receipts of a taxpayer derived from any sale, exchange, or other disposition of agricultural products with respect to which the taxpayer performs storage, handling, or other processing activities (other than transportation activities) within the United States, provided such products are consumed in connection with, or incorporated into, the manufacturing, production, growth, or extraction of qualifying production property (whether or not by the taxpayer).

in the case of a taxpayer engaged in the active conduct of a construction trade or business, construction activities performed in the United States;[23] or (5) in the case of a taxpayer engaged in the active conduct of an engineering or architectural services trade or business, engineering or architectural services performed in the United States for construction projects located in the United States.[24]

However, domestic production gross receipts do not include any gross receipts of the taxpayer derived from property that is leased, licensed, or rented by the taxpayer for use by any related person.[25] Further, domestic production gross receipts do not include any gross receipts of the taxpayer that are derived from the sale of food or beverages prepared by the taxpayer at a retail establishment, that are derived from the transmission or distribution of electricity, gas, and potable water, or that are derived from the lease, rental, license, sale, exchange, or other disposition of land.[26]

Qualifying production property

Qualifying production property generally includes any tangible personal property, computer software, or sound recordings. Qualified film includes any motion picture film or videotape[27] (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of such film (including compensation in the form of residuals and participations)[28] constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.[29] A qualified film also includes any copyrights, trademarks, or other intangibles with respect to such film. The wage limitation for qualified films includes any compensation for services performed in the United States by actors, production personnel, directors, and producers and is not restricted to W–2 wages.[30]

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[23] For this purpose, construction activities include activities that are directly related to the erection or substantial renovation of residential and commercial buildings and infrastructure. Substantial renovation would include structural improvements, but not mere cosmetic changes, such as painting that is not performed in connection with activities that otherwise constitute substantial renovation.

[24] With regard to the definition of "domestic production gross receipts" as it relates to construction performed in the United States and engineering or architectural services performed in the United States for construction projects in the United States, the term refers only to gross receipts derived from the construction of real property by a taxpayer engaged in the active conduct of a construction trade or business, or from engineering or architectural services performed with respect to real property by a taxpayer engaged in the active conduct of an engineering or architectural services trade or business.

[26] Sec. 199(c)(4)(B).

[25] Sec. 199(c)(7). In general, principles similar to those under the extraterritorial income regime apply for this purpose. See Temp. Treas. Reg. sec. 1.927(a)–1T(f)(2)(i). For example, this exclusion generally does not apply to property leased by the taxpayer to a related person if the property is held for sublease, or is subleased, by the related person to an unrelated person for the ultimate use of such unrelated person. Similarly, the license of computer software to a related person for reproduction and sale, exchange, lease, rental or sublicense to an unrelated person for the ultimate use of such unrelated person is not treated as excluded property by reason of the license to the related person.

[27] See Treas. Reg. sec. 1.199–3(k).

[28] To the extent that a taxpayer has included an estimate of participations and/or residuals in its income forecast calculation under section 167(g), the taxpayer must use the same estimate of participations and/or residuals for purposes of determining total compensation.

[29] Treas. Reg. sec. 1.199–2.

[30] Sec. 199(b)(2)(D). Effective for tax years beginning after December 31, 2007.

Other rules

Partnerships and S corporations.—With respect to the domestic production activities of a partnership or S corporation, the deduction under section 199 is applied at the partner or shareholder level.[31] In performing the calculation, each partner or shareholder generally takes into account such person's allocable share of the components of the calculation (including domestic production gross receipts; the cost of goods sold allocable to such receipts; and other expenses, losses, or deductions allocable to such receipts) from the partnership or S corporation [32] as well as any items relating to the partner's or shareholder's own qualified production activities, if any. Each partner or shareholder is treated as having W–2 wages for the taxable year in an amount equal to such person's allocable share of the W–2 wages of the partnership or S corporation for the taxable year.[33]

Trusts and estates.—In the case of a trust or estate, the components of the calculation are apportioned between (and among) the beneficiaries and the fiduciary under regulations prescribed by the Secretary.[34]

Agricultural and horticultural cooperatives.—With regard to member-owned agricultural and horticultural cooperatives formed under Subchapter T of the Code, section 199 provides the same treatment of qualified production activities income derived from agricultural or horticultural products that are manufactured, produced, grown, or extracted by cooperatives,[35] or that are marketed through cooperatives, as it provides for qualified production activities income of other taxpayers, that is, the cooperative may claim a deduction from qualified production activities income.

Alternatively, section 199 provides that the amount of any patronage dividends or per-unit retain allocations paid to a member of an agricultural or horticultural cooperative (to which Part I of Subchapter T applies), which is allocable to the portion of qualified production activities income of the cooperative that is deductible under the provision, is deductible from the gross income of the member. To qualify, such amount must be designated by the organization as allocable to the deductible portion of qualified production activities income in a written notice mailed to its patrons not later than the payment period described in section 1382(d). The cooperative cannot reduce its income under section 1382 (*e.g.*, cannot claim a dividends-paid deduction) for such amounts.

Alternative minimum tax.—The deduction for domestic production activities is allowed for purposes of computing alternative minimum taxable income (including adjusted current earnings). The deduction in computing alternative minimum taxable income is determined by reference to the lesser of the qualified production activities income (as determined for the regular tax) or the alternative minimum taxable income (in the case of an individual, adjusted gross income as determined for the regular tax) without regard to this deduction.

[31] Sec. 199(d)(1)(A)(i).
[32] Sec. 199(d)(1)(A)(ii).
[33] Sec. 199(d)(1)(A)(iii).
[34] See Treas. Reg. secs. 1.199–5(d) and (e).
[35] For this purpose, agricultural or horticultural products also include fertilizer, diesel fuel and other supplies used in agricultural or horticultural production that are manufactured, produced, grown, or extracted by the cooperative.

REASONS FOR CHANGE

The Committee believes that small businesses in the United States are drivers of economic growth and job creation. With more resources at their disposal, U.S. small businesses could invest more in their businesses, hire more employees, and increase wages. The Committee believes that reducing the Federal income tax burden on U.S. small businesses can serve to foster this type of economic and employment growth. H.R. 9, therefore, effectively reduces the Federal income tax rate for U.S. small businesses with fewer than 500 employees—regardless of whether they are organized as passthroughs or as C corporations—by providing a deduction of up to 20 percent of qualified domestic business income. The Committee notes that this definition of small business reflects the definition used by the Small Business Administration's Office of Advocacy. To provide an immediate boost to business activity as the economy continues to struggle, the bill is effective for the first taxable year of the taxpayer beginning after 2011 and would benefit employers with 500 or fewer employees in 2010 or 2011. The Committee believes it is important to establish such a look-back rule in order to remove any incentive for employers to let employees go in order to qualify for the tax benefit. Moreover, the bill provides an incentive for businesses to hire workers by relating the tax benefit to the amount of W–2 wages the business pays (with the amounts of its deduction potentially increasing as its W–2 wage base increases), and allows the service income of partners with small ownership stakes to qualify for this limit. In addition, the Committee recognizes the importance of family-owned and -operated businesses and notes that H.R. 9 contains certain rules designed to ensure that many such businesses would be eligible for this proposed benefit.

EXPLANATION OF PROVISION

In general

In the case of a qualified small business, the provision allows a deduction for 20 percent of qualified domestic business income of the taxpayer for the taxable year, or taxable income for the taxable year, whichever is less. However, a taxpayer's deduction for any taxable year may not exceed 50 percent of certain W–2 wages of the qualified small business.

W–2 wages

Limitation on deduction

The deduction is limited to 50 percent of the greater of (1) W–2 wages paid by the taxpayer to non-owner employees, or (2) the sum of W–2 wages paid by the taxpayer to (a) employees who are non-owner family members of direct owners and (b) employees who are 10-percent-or-less direct owners.

W–2 wages

For purposes of the provision, W–2 wages include the sum of the amounts of wages as defined in section 3401(a) (i.e., wages subject to income tax withholding) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the cal-

endar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and designated Roth contributions (as defined in section 402A).

W–2 wages do not, however, include any amount not properly allocable to domestic business gross receipts under the provision, nor does the term include any amount not allowed as a deduction under section 162 (relating to ordinary and necessary business expenses).[36]

Certain partners' distributive shares of partnership items may be treated as W–2 wages solely for purposes of the provision. In the case of a qualified small business that is a partnership and that so elects, the portion of the qualified domestic business taxable income of the partnership for the taxable year that is allocable to each qualified service-providing partner is treated as W–2 wages paid during that taxable year to an employee who is a 10-percent-or-less direct owner. The domestic business gross receipts of the partnership for the taxable year must be reduced by any amount treated as W–2 wages under this rule.

Non-owner employee

For purposes of the provision, a non-owner employee of a qualified small business means a person who does not own (and is not considered as owning within the meaning of sections 267(c) or (e)(3), as applicable) any stock of the business or, if the business is not a corporation, any capital or profits interest of the business.

Non-owner family member employee

For purposes of this provision, an individual is a non-owner family member of a direct owner if the individual is family (within the meaning of section 267(c)(4)[37]) of a direct owner and would be considered a non-owner if sections 267(c) and (e)(3) were applied without regard to section 267(c)(2).[38] For example, if the son of a direct owner of a corporation is not, himself, a direct owner of the stock of the corporation, is employed by the corporation, and receives W–2 wages from the corporation, the son is considered a non-owner family member of a direct owner.

Direct owner

For purposes of this provision, a direct owner of a qualified small business is a person who owns (or is considered as owning under sections 267(c) or (e)(3) applied without regard to section 267(c)(2)) any stock of such business or, if the business is not a corporation, any capital or profits interest of the qualified small business. Thus, for example, in the case of tiered partnerships, for this purpose, a person who owns an interest in an upper-tier partnership is consid-

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[36] For example, any amount paid to a household employee unrelated to the employer's trade or business is not allowed as a deduction under section 162 since the amount is not an ordinary and necessary business expense. However, amounts paid to employees engaged in the trade or business (regardless of whether such amounts are capitalized into the inventory or under any other provision requiring capitalization) would be qualifying wages for this provision, to the extent such wages are allocable to domestic business gross receipts.

[37] For this purpose, family includes only brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendents.

[38] Sections 267(c) and (e)(3) provide constructive ownership rules for stock and passthrough entities. Section 267(c)(2) treats an individual as owning interests owned by the individual's family.

ered to own an interest in a lower-tier partnership that is a qualified small business.

10-percent-or-less direct owner

For purposes of the provision, in the case of a qualified small business that is a corporation, a 10-percent-or-less direct owner means a direct owner who owns not more than 10 percent of the outstanding stock of the corporation or stock possessing not more than 10 percent of the total combined voting power of all stock of the corporation. In the case of a qualified small business that is not a corporation, a 10-percent-or-less direct owner means a person who owns not more than 10 percent of the capital or profits interest in the qualified small business.

Qualified service-providing partner

For purposes of this provision, a qualified service-providing partner is any partner who is a 10-percent-or-less direct owner and who materially participates in the trade or business to which the qualified domestic business income relates.

Qualified domestic business income

In general

Qualified domestic business income, for any taxable year, means the excess (if any) of (1) the taxpayer's domestic business gross receipts for the taxable year, over the sum of (2) cost of goods sold allocable to such receipts, and the other expenses, losses, or deductions (other than the deduction allowed under this provision) that are properly allocable to such receipts.

Domestic business gross receipts

Domestic business gross receipts means the gross receipts of the taxpayer that is a qualified small business which are effectively connected with the conduct of a trade or business within the United States within the meaning of section 864(c) determined without regard to paragraphs (3), (4), and (5) thereof and substituting "qualified small business (within the meaning of section 200)" for "nonresident alien individual or a foreign corporation" each place it appears therein. Domestic business gross receipts do not include (1) gross receipts derived from the sale or exchange of a capital asset or property used in the trade or business (as defined in section 1231(b)), (2) royalties, rents, dividends, interest, or annuities, and (3) any amount which constitutes wages (as defined in section 3401).

Qualified small business

For purposes of the provision, a qualified small business means an employer engaged in a trade or business if the employer had fewer than 500 full-time equivalent employees ("FTEs") [39] for either calendar year 2010 or 2011. For example, a C corporation, S cor-

[39] The term full-time equivalent employees for this purpose has the meaning given under section 45R(d)(2), without regard to section 45R(d)(5) and (e)(1) and by applying that subsection on a calendar year rather than a taxable year basis. Thus, for this purpose, seasonal employees and self-employed individuals, including partners and sole proprietors, two percent shareholders of an S corporation and five percent owners of the employer are included in the calculation of an employer's FTEs.

poration, partnership, or sole proprietorship with fewer than 500 FTEs in either calendar year 2010 or 2011 may be a qualified small business. In the case of an employer not in existence on January 1, 2012, the determination is made with respect to calendar year 2012 rather than 2010 or 2011.

In general, an employer's FTEs are calculated by dividing the total hours of service for which wages were paid by the employer to employees during the taxable year by 2,080 hours.[40] This number is rounded down to the nearest whole number if not otherwise a whole number. Employers in existence for a partial calendar year annualize the number of FTEs calculated based on the number of calendar days the taxpayer was in existence during 2012.

Any employer that is treated as a single employer for purposes of section 52(a) or (b) (without regard to section 1563(b)), relating to employees of entities under common control, or section 414(m) or (o), relating to employees of an affiliated service group, is treated as a single employer for purposes of determining whether an employer is a qualified small business.

Other rules

Application to passthrough entities and individuals

For purposes of this provision, rules similar to the rules under section 199 (described above) apply with respect to partnerships, S corporations, trusts or estates, or agricultural and horticultural cooperatives.[41] Rules similar to the rules under section 199 also apply with respect to individuals.[42]

Special rule for affiliated groups

All members of an expanded affiliated group are treated as a single corporation for purposes of the provision.[43] Rules similar to the rules under section 199 apply to allocate the deduction among the members of the expanded affiliated group.[44]

Alternative minimum tax

The deduction for qualified domestic business income is allowed for purposes of computing alternative minimum taxable income (including adjusted current earnings). The deduction in computing alternative minimum taxable income is determined by reference to the lesser of the qualified domestic business income (as determined for the regular tax) or the alternative minimum taxable income (in the case of an individual, adjusted gross income as determined for the regular tax) without regard to this deduction.

Coordination with section 199

If a taxpayer is allowed a deduction under this provision for a taxable year, gross receipts of the taxpayer taken into account under this provision cannot be taken into account under section

[40] For employees who work in excess of 2,080 hours during any taxable year, the excess is not taken into account. See sec. 45R(d)(2)(B).

[41] See sec. 199(d)(1) and (3).

[42] See sec. 199(d)(2).

[43] Members of an expanded affiliated group for purposes of this provision generally include those corporations which would be members of an affiliated group if such membership were determined based on an ownership threshold of "more than 50 percent" rather than "at least 80 percent."

[44] See sec. 199(d)(4).

199 for the taxable year. Similarly, W–2 wages taken into account under this provision cannot be taken into account under section 199 (which also has a limitation related to W–2 wages) for the taxable year. As a result, the taxpayer may not benefit under this provision and under section 199 with respect to the same gross receipts or W–2 wages.

A taxpayer may elect not to take into account under this provision any item of domestic business gross receipts. Under this election, for example, the taxpayer may treat an item of domestic business gross receipts as not taken into account under the provision so that the item may be taken into account for purposes of section 199.

Regulations

The Treasury Department is directed to prescribe guidance necessary to carry out the purposes of the provision. This guidance is to include rules preventing a taxpayer that reorganizes or changes its structure from being treated as a qualified small business if it would not have been so treated prior to the reorganization or structural change. The guidance is also to provide rules preventing taxpayers from obtaining a deduction under both section 199 and this provision based on the same gross receipts or W–2 wages.

EFFECTIVE DATE

The provision applies only with respect to the first taxable year of the taxpayer beginning after December 31, 2011.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statements are made concerning the votes of the Committee on Ways and Means in its consideration of H.R. 9, the "Small Business Tax Cut Act."

MOTION TO REPORT RECOMMENDATIONS

The bill, H.R. 9, was ordered favorably reported as amended by a roll call vote of 21 yeas to 14 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp	X	....	....	Mr. Levin	....	X	....
Mr. Herger	X	....	....	Mr. Rangel	....	....	....
Mr. Johnson	X	....	....	Mr. Stark	....	X	....
Mr. Brady	X	....	....	Mr. McDermott	....	X	....
Mr. Ryan	X	....	....	Mr. Lewis	....	X	....
Mr. Nunes	X	....	....	Mr. Neal	....	X	....
Mr. Tiberi	X	....	....	Mr. Becerra	....	X	....
Mr. Davis	X	....	....	Mr. Doggett	....	X	....
Mr. Reichert	X	....	....	Mr. Thompson	....	X	....
Mr. Boustany	X	....	....	Mr. Larson	....	X	....
Mr. Roskam	X	....	....	Mr. Blumenauer	....	X	....
Mr. Gerlach	X	....	....	Mr. Kind	....	X	....
Mr. Price	X	....	....	Mr. Pascrell	....	X	....
Mr. Buchanan	X	....	....	Ms. Berkley	....	X	....
Mr. Smith	X	....	....	Mr. Crowley	....	X	....
Mr. Schock	X	....	....				
Ms. Jenkins	X	....	....				
Mr. Paulsen	X	....	....				
Mr. Marchant	....	....	....				

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Berg	X						
Ms. Black	X						
Mr. Reed	X						

VOTES ON AMENDMENTS AND OTHER MOTIONS

The vote on the motion by Mr. Brady to table Mr. Becerra's challenge to the rule of the Chair was agreed to by a roll call vote of 20 yeas to 14 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp	X			Mr. Levin		X	
Mr. Herger	X			Mr. Rangel			
Mr. Johnson	X			Mr. Stark		X	
Mr. Brady	X			Mr. McDermott		X	
Mr. Ryan	X			Mr. Lewis		X	
Mr. Nunes	X			Mr. Neal		X	
Mr. Tiberi	X			Mr. Becerra		X	
Mr. Davis	X			Mr. Doggett		X	
Mr. Reichert	X			Mr. Thompson		X	
Mr. Boustany	X			Mr. Larson		X	
Mr. Roskam				Mr. Blumenauer		X	
Mr. Gerlach	X			Mr. Kind		X	
Mr. Price	X			Mr. Pascrell		X	
Mr. Buchanan	X			Ms. Berkley		X	
Mr. Smith	X			Mr. Crowley		X	
Mr. Schock	X						
Ms. Jenkins	X						
Mr. Paulsen	X						
Mr. Marchant							
Mr. Berg	X						
Ms. Black	X						
Mr. Reed	X						

The vote on the motion by Mr. Brady to table Mr. McDermott's motion to appeal the ruling of the Chair was agreed to by a roll call vote of 21 yeas and 13 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp	X			Mr. Levin		X	
Mr. Herger	X			Mr. Rangel			
Mr. Johnson	X			Mr. Stark		X	
Mr. Brady	X			Mr. McDermott		X	
Mr. Ryan	X			Mr. Lewis		X	
Mr. Nunes	X			Mr. Neal		X	
Mr. Tiberi	X			Mr. Becerra		X	
Mr. Davis	X			Mr. Doggett		X	
Mr. Reichert	X			Mr. Thompson		X	
Mr. Boustany	X			Mr. Larson		X	
Mr. Roskam	X			Mr. Blumenauer		X	
Mr. Gerlach	X			Mr. Kind			
Mr. Price	X			Mr. Pascrell		X	
Mr. Buchanan	X			Ms. Berkley		X	
Mr. Smith	X			Mr. Crowley		X	
Mr. Schock	X						
Ms. Jenkins	X						
Mr. Paulsen	X						
Mr. Marchant							
Mr. Berg	X						
Ms. Black	X						
Mr. Reed	X						

The vote on the amendment by Mr. Crowley to the amendment in the nature of a substitute, which would deny the deduction in certain circumstances, was not agreed to by a roll call vote of 21 nays to 14 yeas (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Camp	....	X	....	Mr. Levin	X	....	....
Mr. Herger	....	X	....	Mr. Rangel	....	....	....
Mr. Johnson	....	X	....	Mr. Stark	X	....	....
Mr. Brady	....	X	....	Mr. McDermott	X	....	....
Mr. Ryan	....	X	....	Mr. Lewis	X	....	....
Mr. Nunes	....	X	....	Mr. Neal	X	....	....
Mr. Tiberi	....	X	....	Mr. Becerra	X	....	....
Mr. Davis	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Boustany	....	X	....	Mr. Larson	X	....	....
Mr. Roskam	....	X	....	Mr. Blumenauer	X	....	....
Mr. Gerlach	....	X	....	Mr. Kind	X	....	....
Mr. Price	....	X	....	Mr. Pascrell	X	....	....
Mr. Buchanan	....	X	....	Ms. Berkley	X	....	....
Mr. Smith	....	X	....	Mr. Crowley	X	....	....
Mr. Schock	....	X	....				
Ms. Jenkins	....	X	....				
Mr. Paulsen	....	X	....				
Mr. Marchant	....	....	....				
Mr. Berg	....	X	....				
Ms. Black	....	X	....				
Mr. Reed	....	X	....				

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the revenue provisions of the bill, H.R. 9, as reported.

The bill is estimated to have the following effects on Federal budget receipts for fiscal years 2012–2022:

FISCAL YEARS

[Millions of dollars]

Item	2012	2013	2014	2015	2016	2017	2012–17	2012–22
20-Percent Business Deduction ...	−12,526	−32,714	−709	....	....	....	−45,950	−45,950

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue reducing income tax provisions involve increased tax expenditures. (See amounts in table in Part IV.A., above.)

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, April 9, 2012.

Hon. Dave Camp,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 9, the Small Business Tax Cut Act.

If you wish further details on this estimate, we will be pleased to provide them. The staff contact is Kalyani Parthasarathy.

Sincerely,

Douglas W. Elmendorf.

Enclosure.

H.R. 9—Small Business Tax Cut Act

H.R. 9 would amend the Internal Revenue Code to permit certain small businesses to deduct from their taxable income up to 20 percent of their qualifying domestic business income. The deduction would apply only to the entity's first taxable year that begins after December 31, 2011, and it could not exceed 50 percent of certain wages that the firm pays or reduce the firm's taxable income below zero. The staff of the Joint Committee on Taxation (JCT) estimates that enacting H.R. 9 would reduce revenues, thus increasing federal budget deficits by $46 billion over the 2012–2022 period.

H.R. 9 would define qualifying domestic business income as the excess of gross receipts earned from domestic activities over all costs, expenses, or other deductions related to such receipts. A small business would be eligible for the deduction if it engaged in a trade or business and had fewer than 500 full-time equivalent employees in either calendar year 2010 or 2011. If the business was not in existence in those years, then the test would be applied to the firm in 2012.

The Statutory Pay-As-You-Go Act of 2010 establishes budget reporting and enforcement procedures for legislation affecting direct spending and revenues. Enacting H.R. 9 would result in revenue losses in each year from 2012 to 2014. The net change in revenues is shown in the following table.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS OF H.R. 9, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON WAYS AND MEANS ON MARCH 28, 2012

	By fiscal year, in millions of dollars—												
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2012–2017	2012–2022
NET INCREASE OR DECREASE (−) IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	12,526	32,714	709	0	0	0	0	0	0	0	0	45,950	45,950

JCT has determined that the bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

The CBO staff contact for this estimate is Kalyani Parthasarathy. The estimate was approved by Frank Sammartino, Assistant Director for Tax Analysis.

D. Macroeconomic Impact Analysis

In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of H.R. 9: the effects of the bill on economic activity are so small as to be incalculable within the context of a model of the aggregate economy.

The bill will potentially have small, temporary stimulative effects. It will temporarily increase after-tax income for the owners of certain firms with fewer than 500 employees, enabling these taxpayers to increase their purchase of goods and services. Because the economy is currently operating at less than full employment, this additional demand is likely to have a temporary stimulus effect, resulting in a small increase in real Gross Domestic Product ("GDP") during the time the provision is in effect (in 2012 and for some taxpayers part of 2013, depending on their taxable year). The size of this stimulus effect depends on how much of the after-tax income the business owners choose to spend, which is uncertain. The size of the tax reduction ($45.9 billion) is quite small relative to the size of the economy (0.003 percent of projected GDP in 2012), which means the stimulus effect will also be quite small. As the tax reduction expires, the stimulus effect also expires.

In addition, the bill provides an incentive to shift profits to the period when they are taxed at lower effective rates. Firms have an incentive to shift sales, and, if necessary, commensurate production and employment, into the period of the tax deduction. However, this incentive is partially offset by associated adjustment costs, such as additional overtime or hiring costs, and additional wear and tear on equipment. The formula for determining the amount of the business deduction makes it possible for firms to maximize the deduction bonus without increasing output. Firms might not need to increase their productive capacity to take full advantage of the tax benefits of the bill. To the extent that firms could increase sales and or payroll to take advantage of the extra deduction without increasing longer-term costs, they can be expected to do that. Thus, the bill is likely to result in some acceleration of sales into the current taxable year, but very little change in output over the budget period.

The temporary nature of the bill significantly limits incentives it might otherwise provide for a direct increase in production by the affected firms. Generally, a longer-term reduction in taxation of business profits of the type that is provided for only one year in this bill would increase the rate of return to production, thus providing businesses with an incentive to increase investment and output. However, the one year of tax savings provided by the bill is unlikely to make the costs of much investment in physical capital or labor recruitment and training worthwhile.

The increase in the deficit as a result of the bill may slightly increase long-term interest rates. In the near term, this effect is likely to be negligible both because the economy is currently operating below capacity, and because the Federal Reserve Board has announced an intention to keep interest rates low through 2014. Because the provision is temporary, there is no offsetting permanent increase in after-tax capital returns. Thus, the incentive for long-term capital investment is reduced in the future, putting slight downward pressure on economic growth.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. COMMITTEE OVERSIGHT FINDINGS AND RECOMMENDATIONS

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was as a result of the Committee's review of the provisions of H.R. 9 that the Committee concluded that it is appropriate to report the bill, as amended, to the House of Representatives with the recommendation that the bill do pass.

B. STATEMENT OF GENERAL PERFORMANCE GOALS AND OBJECTIVES

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. INFORMATION RELATING TO UNFUNDED MANDATES

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the reported bill does not contain any Federal private sector mandates within the meaning of Public Law No. 104–4, the Unfunded Mandates Reform Act of 1995. The costs required to comply with each Federal private sector mandate generally are no greater than the aggregate estimated budget effects of the provision.

The Committee has determined that the revenue provisions of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. APPLICABILITY OF HOUSE RULE XXI 5(b)

Clause 5(b) of rule XXI of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increases within the meaning of the rule.

E. TAX COMPLEXITY ANALYSIS

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses. Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, a summary description of that provision is provided, along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and the Treasury Department regarding each of the provisions included in the tax complexity analysis, including a discussion of the likely effect on IRS forms and any expected impact on the IRS.

Summary description of the provision

In the case of a qualified small business, the provision allows a deduction for 20 percent of qualified domestic business income of the taxpayer for the taxable year, or taxable income for the taxable year, whichever is less. However, a taxpayer's deduction for any taxable year is limited to 50 percent of the greater of (1) W–2 wages paid by the taxpayer to non-owner employees, or (2) the sum of W–2 wages paid by the taxpayer to (a) employees who are non-owner family members of direct owners and (b) employees who are 10 percent-or-less direct owners.

For purposes of the provision, a qualified small business means an employer engaged in a trade or business that employed fewer than 500 full-time equivalent employees for either calendar year 2010 or 2011. Any employer treated as a single employer for purposes of section 52(a) or (b) (without regard to section 1563(b)), or section 414(m) or (o) is treated as a single employer for this purpose. Qualified domestic business income means the excess (if any) of (1) the taxpayer's gross receipts effectively connected with a trade or business in the United States, over (2) the sum of cost of goods sold, expenses, losses, and other deductions properly allocable to such receipts. For purposes of this provision, W–2 wages include (1) wages as defined in section 3401(a), (2) elective deferrals reported to the Social Security Administration, and (3) certain partners' distributive share of partnership items if the partnership so elects. A partnership can elect to treat partnership income allocable to partners who materially participate in the related trade or business, and who own 10 percent or less of the partnership, as W–2 wages for purposes of this provision.

Deductions cannot be taken under the provision and present law section 199 with respect to the same gross receipts. Similarly, W–2 wages taken into account under the provision cannot also be taken into account under section 199. Rules similar to those applicable for section 199 in the case of partnerships, S corporations,

trusts and estates, and agricultural and horticultural cooperatives apply for purposes of the provision.

The provision applies only with respect to the first taxable year of the taxpayer beginning after December 31, 2011.

Number of affected taxpayers

It is estimated that the provision will affect more than 10 percent of small businesses and individuals.

Discussion

It is anticipated that small businesses that elect to apply the provision will need to keep additional records due to this provision, and that additional regulatory guidance will be necessary to effectively implement the provision. It is anticipated that the provision will result in an increase in disputes between small businesses and the IRS. Reasons for such disputes include the complexity of the provision and the inherent incentive for taxpayers to maximize the deduction.

The provision likely will increase the tax preparation costs for most affected small businesses. Small businesses will have to perform additional analysis concerning whether the small business had no more than 500 employees and which income qualifies for the deduction allowed under the provision. For income that is determined to be eligible for the deduction under the provision, small businesses will be required to perform additional calculations to determine the amount of the deduction under the provision. Because the deduction is based upon qualified domestic business income rather than gross income, small businesses will be required to undertake calculations to determine the amounts of costs that are allocable to domestic business gross receipts. In some cases, small businesses would not have been required otherwise to perform these calculations but for the provision.

The wage limitation on the deduction is likely to impact small businesses disproportionately. Small businesses will have to perform additional analysis concerning the amount of wages paid to non-owner employees, employees who are family members of direct owners, and employees who are 10 percent-or-less direct owners. Small businesses that are partnerships will have to analyze whether to elect to treat partnership income allocable to partners who materially participate in the related trade or business, and who own 10 percent or less of the partnership, as W–2 wages for purposes of this provision. After undertaking analyses to determine the amount of their potential deduction, many small businesses will find that such amount is significantly reduced or eliminated by the wage limitation. Small businesses may wish to increase or decrease wages paid to employees in various categories or hire additional employees in various categories in order to maximize the deduction under this provision. Small businesses affected by the wage limitation may wish to take certain gross receipts into account under section 199 instead of this provision.

Due to the detailed calculations required by the provision, it is anticipated that the Secretary of the Treasury will have to create a new form for qualified small businesses to compute the deduction and will have to make appropriate revisions to several types of income tax forms and instructions. In addition, the Secretary of the

Treasury will have to issue guidance to carry out the purposes of the provision, including rules preventing a taxpayer that reorganizes or changes its structure from being treated as a qualified small business if it would not have been so treated prior to the reorganization or structural change and rules preventing taxpayers from obtaining a deduction under both section 199 and this provision based on the same gross receipts or W–2 wages.

COMMENTS FROM IRS AND TREASURY

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC, April 3, 2012.

Mr. THOMAS A. BARTHOLD,
Chief of Staff, Joint Committee on Taxation,
Washington, D.C.

DEAR MR. BARTHOLD: I am responding to your letter dated March 29, 2012, in which you requested a complexity analysis related to the deduction for domestic business income of qualified small businesses enacted under section 2 of the Small Business Tax Cut Act.

Enclosed are the combined comments of the Internal Revenue Service and the Treasury Department for inclusion in the complexity analysis in the Conference Report on H.R. 9.

Our comments are based on the description of the provision provided in your letter. The analysis does not include administrative cost estimates for the changes that would be required. Due to the short turnaround time, our comments are provisional and subject to change upon a more complete and in-depth analysis of the provision. The analysis does not cover any other provisions of the bill.

Sincerely,

DOUGLAS H. SHULMAN.

Enclosure.

COMPLEXITY ANALYSIS OF THE CONFERENCE REPORT ON H.R. 9, SMALL BUSINESS TAX CUT ACT

DEDUCTION FOR DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES

In the case of a qualified small business, the provision allows a deduction of up to 20 percent of the qualified domestic business income of the taxpayer for the taxable year. The deduction is limited to the lesser of (1) 20 percent of the taxpayer's taxable income or (2) 50 percent of certain W–2 wages paid (or in some cases, deemed paid) by the taxpayer.

For purposes of the provision, a qualified small business means an employer engaged in a trade or business that employed fewer than 500 full-time equivalent employees for either calendar year 2010 or 2011. Any employer treated as a single employer for purposes of section 52(a) or (b) (without regard to section 1563(b) or section 414(m) or (o) is treated as a single employer for this purpose. Qualified domestic business income means the excess (if any) of (1) the taxpayer's gross receipts effectively connected with a trade or business in the United States, over (2) the sum of cost of goods sold, expenses, losses, and other deductions properly allo-

cable to such receipts. W–2 wages include (1) wages as defined in section 3401(a) and (2) elective deferrals reported to the Social Security Administration and, solely for purposes of the provision (3) certain partners' distributive share of partnership items if the partnership so elects. A partnership can elect to treat partnership income allocable to partners who materially participate in the related trade or business, and who own 10 percent or less of the partnership, as W–2 wages for purposes of this provision.

Deductions cannot be taken under the provision and present law section 199 with respect to the same gross receipts. Similarly, W–2 wages taken into account under the provision cannot also be taken into account under section 199. Rules similar to those applicable for section 199, in the case of partnerships, S corporations, trusts and estates and agricultural and horticultural cooperatives, apply for purposes of the provision.

The provision applies only with respect to the first taxable year of the taxpayer beginning after December 31, 2011.

IRS and Treasury Comments

- The provision applies at the individual and corporate level and would "follow" the present law section 199 rules [Domestic Production Activities Deduction (DPAD)].
- The provision is, for the most part, taken in lieu of the section 199 DPAD (which is calculated on the current Form 8903).
- A new form 8903–A would need to be developed for this deduction.
- Where the deduction is calculated on the current Form 8903 and carried forward to the various individual and corporate tax return lines, this deduction would be calculated on new Form 8903–A and carried forward to the same various individual and corporate tax return lines.
- The new Form 8903–A would be complicated and would be similar to current Form 8903 but without the column for oil and gas. Form 1040, Line 35, and Form 1120, Line 25, allow for the DAPD and indicates the taxpayer should attach Form 8903.
- The reference to attaching Form 8903 on this line would need to be modified to indicate attachment of either Form 8903 or new Form 8903–A.
- Form 6251, Alternative Minimum Tax: The form may need to be modified.
- Form 1065, Partnership Income Tax Return: The deduction would be applied at the partner level. The deduction from this provision would be a separately stated item on Schedule K and Schedule K–1. The instructions for both would need modification and a new letter code would need to be added to Schedule K–1.
- Form 1120S, S Corporation Income Tax Return: The deduction would be applied at the shareholder level. As such, applicable modifications to the instructions for Schedule K–1 would be needed.
- IRS would need to communicate and educate internal and external stakeholders regarding the new law.
- New guidance in the form of a Notice or other vehicle as well as Regulations would be required.
- Limited changes would be needed to the affected IRM sections.

- IRS may need to modify existing tax systems to reflect this provision.
- If this line item is to be transcribed, additional resources would be needed.
- Policies, procedures and analysis of transcription results would require additional resources.
- Disputes between taxpayers and IRS may arise about the definition of a qualified small business, the type of employer and the type of trade or business, the FTE calculation, application at the partner or shareholder level, the definition of domestic production gross receipts, the definition of qualifying production property; the definitions of service-providing partner; non-owner employees, non-owner family member of direct owners; and the calculation of the possible 20 percent deduction.

F. Congressional Earmarks, Limited Tax Benefits, and Limited Tariff Benefits

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill as reported contain no congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of that rule.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

Subtitle A—Income Taxes

* * * * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * * * *

Subchapter A—Determination of Tax Liability

* * * * * * *

PART VI—ALTERNATIVE MINIMUM TAX

* * * * * * *

SEC. 56. ADJUSTMENTS IN COMPUTING ALTERNATIVE MINIMUM TAXABLE INCOME.

(a) * * *

* * * * * * *

(d) ALTERNATIVE TAX NET OPERATING LOSS DEDUCTION DEFINED.—

(1) IN GENERAL.—For purposes of subsection (a)(4), the term "alternative tax net operating loss deduction" means the net operating loss deduction allowable for the taxable year under section 172, except that—

(A) the amount of such deduction shall not exceed the sum of—

(i) the lesser of—

(I) * * *

(II) 90 percent of alternative minimum taxable income determined without regard to such deduction and the [deduction under section 199] *deductions under sections 199 and 200*, plus

(ii) the lesser of—

(I) * * *

(II) alternative minimum taxable income determined without regard to such deduction and the [deduction under section 199] *deductions under sections 199 and 200* reduced by the amount determined under clause (i), and

* * * * * * *

(g) ADJUSTMENTS BASED ON ADJUSTED CURRENT EARNINGS.—

(1) * * *

* * * * * * *

(4) ADJUSTMENTS.—In determining adjusted current earnings, the following adjustments shall apply:

(A) * * *

* * * * * * *

(C) DISALLOWANCE OF ITEMS NOT DEDUCTIBLE IN COMPUTING EARNINGS AND PROFITS.—

(i) * * *

* * * * * * *

(vii) DEDUCTION FOR DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES.—Clause (i) shall not apply to any amount allowable as a deduction under section 200.

* * * * * * *

Subchapter B—Computation of Taxable Income

* * * * * * *

PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

* * * * * * *

SEC. 86. SOCIAL SECURITY AND TIER 1 RAILROAD RETIREMENT BENEFITS.

(a) * * *

(b) TAXPAYERS TO WHOM SUBSECTION (a) APPLIES.—

(1) * * *

(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term "modified adjusted gross income" means adjusted gross income—

(A) determined without regard to this section and sections 135, 137, 199, *200,* 221, 222, 911, 931, and 933, and

* * * * * * *

PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

* * * * * * *

SEC. 135. INCOME FROM UNITED STATES SAVINGS BONDS USED TO PAY HIGHER EDUCATION TUITION AND FEES.

(a) * * *

* * * * * * *

(c) DEFINITIONS.—For purposes of this section—

(1) * * *

* * * * * * *

(4) MODIFIED ADJUSTED GROSS INCOME.—The term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year determined—

(A) without regard to this section and sections 137, 199, *200,* 221, 222, 911, 931, and 933, and

* * * * * * *

SEC. 137. ADOPTION ASSISTANCE PROGRAM.

(a) * * *

(b) LIMITATIONS.—

(1) * * *

* * * * * * *

(3) DETERMINATION OF ADJUSTED GROSS INCOME.—For purposes of paragraph (2), adjusted gross income shall be determined—

(A) without regard to this section and sections 199, *200,* 221, 222, 911, 931, and 933, and

* * * * * * *

PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

Sec. 161. Allowance of deductions.

* * * * * * *

Sec. 200. Domestic business income of qualified small businesses.

* * * * * * *

SEC. 163. INTEREST.

(a) * * *

* * * * * * *

(j) LIMITATION ON DEDUCTION FOR INTEREST ON CERTAIN INDEBTEDNESS.—

(1) * * *

* * * * * * *

(6) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) ADJUSTED TAXABLE INCOME.—The term “adjusted taxable income” means the taxable income of the taxpayer—

(i) computed without regard to—

(I) * * *

* * * * * * *

(III) any deduction allowable under section 199, [and]

* * * * * * *

(V) any deduction allowable under section 200, and

* * * * * * *

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) * * *

(b) PERCENTAGE LIMITATIONS.—

(1) * * *

(2) CORPORATIONS.—In the case of a corporation—

(A) * * *

* * * * * * *

(C) TAXABLE INCOME.—For purposes of this paragraph, taxable income shall be computed without regard to—

(i) * * *

* * * * * * *

(iv) section 199, [and]

(v) any capital loss carryback to the taxable year under section 1212(a)(1)[.]*, and*

(vi) section 200.

* * * * * * *

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) * * *

* * * * * * *

(d) MODIFICATIONS.—The modifications referred to in this section are as follows:

(1) * * *

* * * * * * *

(8) DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES.—The deduction under section 200 shall not be allowed.

* * * * * * *

SEC. 200. DOMESTIC BUSINESS INCOME OF QUALIFIED SMALL BUSINESSES.

(a) ALLOWANCE OF DEDUCTION.—In the case of a qualified small business, there shall be allowed as a deduction an amount equal to 20 percent of the lesser of—

(1) the qualified domestic business income of the taxpayer for the taxable year, or

(2) taxable income (determined without regard to this section) for the taxable year.

(b) DEDUCTION LIMITED BASED ON WAGES PAID.—

(1) IN GENERAL.—The amount of the deduction allowable under subsection (a) for any taxable year shall not exceed 50 percent of the greater of—

(A) the W–2 wages of the taxpayer paid to non-owners, or

(B) the sum of—

(i) the W–2 wages of the taxpayer paid to individuals who are non-owner family members of direct owners, plus

(ii) any W–2 wages of the taxpayer paid to 10-percent-or-less direct owners.

(2) DEFINITIONS RELATED TO OWNERSHIP.—For purposes of this section—

(A) NON-OWNER.—The term "non-owner" means, with respect to any qualified small business, any person who does not own (and is not considered as owning within the meaning of subsection (c) or (e)(3) of section 267, as the case may be) any stock of such business (or, if such business is other than a corporation, any capital or profits interest of such business).

(B) NON-OWNER FAMILY MEMBERS.—An individual is a non-owner family member of a direct owner if—

(i) such individual is family (within the meaning of section 267(c)(4)) of a direct owner, and

(ii) such individual would be a non-owner if subsections (c) and (e)(3) of section 267 were applied without regard to section 267(c)(2).

(C) DIRECT OWNER.—The term "direct owner" means, with respect to any qualified small business, any person who owns (or is considered as owning under the applicable non-family attribution rules) any stock of such business (or, if such business is other than a corporation, any capital or profits interest of such business).

(D) 10-PERCENT-OR-LESS DIRECT OWNERS.—The term "10-percent-or-less direct owner" means, with respect to any qualified small business, any direct owner of such business who owns (or is considered as owning under the applicable non-family attribution rules)—

(i) in the case of a qualified small business which is a corporation, not more than 10 percent of the outstanding stock of the corporation or stock possessing more than 10 percent of the total combined voting power of all stock of the corporation, or

(ii) in the case of a qualified small business which is not a corporation, not more than 10 percent of the capital or profits interest of such business.

(E) APPLICABLE NON-FAMILY ATTRIBUTION RULES.—The term "applicable non-family attribution rules" means the attribution rules of subsection (c) or (e)(3) of section 267, as the case may be, but in each case applied without regard to section 267(c)(2).

(3) W–2 WAGES.—For purposes of this section—

(A) IN GENERAL.—The term "W–2 wages" means, with respect to any person for any taxable year of such person, the sum of the amounts described in paragraphs (3) and (8) of

section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

(B) LIMITATION TO WAGES ATTRIBUTABLE TO QUALIFIED DOMESTIC BUSINESS INCOME.—Such term shall not include any amount which is not properly allocable to domestic business gross receipts for purposes of subsection (c)(1).

(C) OTHER REQUIREMENTS.—Except in the case of amounts treated as W–2 wages under paragraph (4)—

(i) such term shall not include any amount which is not allowed as a deduction under section 162 for the taxable year, and

(ii) such term shall not include any amount which is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.

(4) CERTAIN PARTNERSHIP DISTRIBUTIONS TREATED AS W–2 WAGES.—

(A) IN GENERAL.—In the case of a qualified small business which is a partnership and elects the application of this paragraph for the taxable year—

(i) the qualified domestic business taxable income of such partnership for such taxable year (determined after the application of clause (ii)) which is allocable under rules similar to the rules of section 199(d)(1)(A)(ii) to each qualified service-providing partner shall be treated for purposes of this section as W–2 wages paid during such taxable year to such partner as an employee, and

(ii) the domestic business gross receipts of such partnership for such taxable year shall be reduced by the amount so treated.

(B) QUALIFIED SERVICE-PROVIDING PARTNER.—For purposes of this paragraph, the term "qualified service-providing partner" means, with respect to any qualified domestic business taxable income, any partner who is a 10-percent-or-less direct owner and who materially participates in the trade or business to which such income relates.

(5) ACQUISITIONS AND DISPOSITIONS.—The Secretary shall provide for the application of this subsection in cases where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

(c) QUALIFIED DOMESTIC BUSINESS INCOME.—For purposes of this section—

(1) IN GENERAL.—The term "qualified domestic business income" for any taxable year means an amount equal to the excess (if any) of—

(A) the taxpayer's domestic business gross receipts for such taxable year, over

(B) the sum of—

(i) the cost of goods sold that are allocable to such receipts, and

(ii) other expenses, losses, or deductions (other than the deduction allowed under this section), which are properly allocable to such receipts.

(2) DOMESTIC BUSINESS GROSS RECEIPTS.—

(A) IN GENERAL.—The term "domestic business gross receipts" means the gross receipts of the taxpayer which are effectively connected with the conduct of a trade or business within the United States within the meaning of section 864(c) but determined—

(i) without regard to paragraphs (3), (4), and (5) thereof, and

(ii) by substituting "qualified small business (within the meaning of section 200)" for "nonresident alien individual or a foreign corporation" each place it appears therein.

(B) EXCEPTIONS.—For purposes of paragraph (1), domestic business gross receipts shall not include any of the following:

(i) Gross receipts derived from the sale or exchange of—

(I) a capital asset, or

(II) property used in the trade or business (as defined in section 1231(b)).

(ii) Royalties, rents, dividends, interest, or annuities.

(iii) Any amount which constitutes wages (as defined in section 3401).

(3) APPLICATION OF CERTAIN RULES.—Rules similar to the rules of paragraphs (2) and (3) of section 199(c) shall apply for purposes of this section (applied with respect to qualified domestic business income in lieu of qualified production activities income and with respect to domestic business gross receipts in lieu of domestic production gross receipts).

(d) QUALIFIED SMALL BUSINESS.—For purposes of this section—

(1) IN GENERAL.—The term "qualified small business" means any employer engaged in a trade or business if such employer had fewer than 500 full-time equivalent employees for either calendar year 2010 or 2011.

(2) FULL-TIME EQUIVALENT EMPLOYEES.—The term "full-time equivalent employees" has the meaning given such term by subsection (d)(2) of section 45R applied—

(A) without regard to subsection (d)(5) of such section,

(B) with regard to subsection (e)(1) of such section, and

(C) by substituting "calendar year" for "taxable year" each place it appears therein.

(3) EMPLOYERS NOT IN EXISTENCE PRIOR TO 2012.—In the case of an employer which was not in existence on January 1, 2012, the determination under paragraph (1) shall be made with respect to calendar year 2012.

(4) APPLICATION TO CALENDAR YEARS IN WHICH EMPLOYER IN EXISTENCE FOR PORTION OF CALENDAR YEAR.—In the case of any calendar year during which the employer comes into existence, the number of full-time equivalent employees determined under paragraph (2) with respect to such calendar year shall be increased by multiplying the number so determined (without regard to this paragraph) by the quotient obtained by dividing—

(A) the number of days in such calendar year, by

(B) the number of days during such calendar year which such employer is in existence.

(5) SPECIAL RULES.—

(A) AGGREGATION RULE.—For purposes of paragraph (1), any person treated as a single employer under subsection (a) or (b) of section 52 (applied without regard to section 1563(b)) or subsection (m) or (o) of section 414 shall be treated as a single employer for purposes of this subsection.

(B) PREDECESSORS.—Any reference in this subsection to an employer shall include a reference to any predecessor of such employer.

(e) SPECIAL RULES.—

(1) ELECTIVE APPLICATION OF DEDUCTION.—Except as otherwise provided by the Secretary, the taxpayer may elect not to take any item of income into account as domestic business gross receipts for purposes of this section.

(2) COORDINATION WITH SECTION 199.—If a deduction is allowed under this section with respect to any taxpayer for any taxable year—

(A) any gross receipts of the taxpayer which are taken into account under this section for such taxable year shall not be taken into account under section 199 for such taxable year, and

(B) the W–2 wages of the taxpayer which are taken into account under this section shall not be taken into account under section 199 for such taxable year.

(3) APPLICATION OF CERTAIN RULES.—Rules similar to the rules of paragraphs (1), (2), (3), (4), (6), and (7) of section 199(d) shall apply for purposes of this section (applied with respect to qualified domestic business income in lieu of qualified production activities income).

(f) REGULATIONS.—The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section, including regulations which prevent a taxpayer which reorganizes from being treated as a qualified small business if such taxpayer would not have been treated as a qualified small business prior to such reorganization.

(g) APPLICATION.—Subsection (a) shall apply only with respect to the first taxable year of the taxpayer beginning after December 31, 2011.

PART VII—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

* * * * * * *

SEC. 219. RETIREMENT SAVINGS.

(a) * * *

* * * * * * *

(g) LIMITATION ON DEDUCTION FOR ACTIVE PARTICIPANTS IN CERTAIN PENSION PLANS.—

(1) * * *

* * * * * * *

(3) ADJUSTED GROSS INCOME; APPLICABLE DOLLAR AMOUNT.—For purposes of this subsection—

(A) ADJUSTED GROSS INCOME.—Adjusted gross income of any taxpayer shall be determined—

(i) * * *

(ii) without regard to sections 135, 137, 199, *200,* 221, 222, and 911 or the deduction allowable under this section.

* * * * * * *

SEC. 221. INTEREST ON EDUCATION LOANS.

(a) * * *

(b) MAXIMUM DEDUCTION.—

(1) * * *

(2) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

(A) * * *

* * * * * * *

(C) MODIFIED ADJUSTED GROSS INCOME.—The term "modified adjusted gross income" means adjusted gross income determined—

(i) without regard to this section and sections 199, *200,* 222, 911, 931, and 933, and

* * * * * * *

SEC. 222. QUALIFIED TUITION AND RELATED EXPENSES.

(a) * * *

(b) DOLLAR LIMITATIONS.—

(1) * * *

(2) APPLICABLE DOLLAR LIMIT.—

(A) * * *

* * * * * * *

(C) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined—

(i) without regard to this section and sections 199, *200,* 911, 931, and 933, and

* * * * * * *

PART VIII—SPECIAL DEDUCTIONS FOR CORPORATIONS

* * * * * * *

SEC. 246. RULES APPLYING TO DEDUCTIONS FOR DIVIDENDS RECEIVED.

(a) * * *

(b) LIMITATION ON AGGREGATE AMOUNT OF DEDUCTIONS.—

(1) GENERAL RULE.—Except as provided in paragraph (2), the aggregate amount of the deductions allowed by sections 243(a)(1), 244(a), and subsection (a) or (b) of section 245 shall not exceed the percentage determined under paragraph (3) of the taxable income computed without regard to the deductions allowed by sections 172, 199, *200,* 243(a)(1), 244(a), subsection (a) or (b) of section 245, and 247, without regard to any adjust-

ment under section 1059, and without regard to any capital loss carryback to the taxable year under section 1212(a)(1).

* * * * * * *

Subchapter E—Accounting Periods and Methods of Accounting

* * * * * * *

PART II—METHODS OF ACCOUNTING

* * * * * * *

Subpart C—Taxable Year for Which Deductions Taken

* * * * * * *

SEC. 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

(a) * * *

* * * * * * *

(i) $25,000 OFFSET FOR RENTAL REAL ESTATE ACTIVITIES.—

(1) * * *

* * * * * * *

(3) PHASE-OUT OF EXEMPTION.—

(A) * * *

* * * * * * *

(F) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined without regard to—

(i) * * *

* * * * * * *

(iii) the amounts allowable as a deduction under sections 199, *200,* 219, 221, and 222, and

* * * * * * *

Subchapter I—Natural Resources

* * * * * * *

PART I—DEDUCTIONS

* * * * * * *

SEC. 613. PERCENTAGE DEPLETION.

(a) GENERAL RULE.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent (100 percent in the case of oil and gas properties) of the taxpayer's taxable income from the property (computed without allowance for depletion and without the [deduction under section 199] *deductions under sections 199 and 200*).

For purposes of the preceding sentence, the allowable deductions taken into account with respect to expenses of mining in computing the taxable income from the property shall be decreased by an amount equal to so much of any gain which (1) is treated under section 1245 (relating to gain from disposition of certain depreciable property) as ordinary income, and (2) is properly allocable to the property. In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

* * * * * * *

SEC. 613A. LIMITATIONS ON PERCENTAGE DEPLETION IN CASE OF OIL AND GAS WELLS.

(a) * * *

* * * * * * *

(d) LIMITATIONS ON APPLICATION OF SUBSECTION (c).—

(1) LIMITATION BASED ON TAXABLE INCOME.—The deduction for the taxable year attributable to the application of subsection (c) shall not exceed 65 percent of the taxpayer's taxable income for the year computed without regard to—

(A) * * *

* * * * * * *

(C) any deduction allowable under section 200,

【(C)】 *(D)* any net operating loss carryback to the taxable year under section 172,

【(D)】 *(E)* any capital loss carryback to the taxable year under section 1212, and

【(E)】 *(F)* in the case of a trust, any distributions to its beneficiary, except in the case of any trust where any beneficiary of such trust is a member of the family (as defined in section 267(c)(4)) of a settlor who created inter vivos and testamentary trusts for members of the family and such settlor died within the last six days of the fifth month in 1970, and the law in the jurisdiction in which such trust was created requires all or a portion of the gross or net proceeds of any royalty or other interest in oil, gas, or other mineral representing any percentage depletion allowance to be allocated to the principal of the trust.

If an amount is disallowed as a deduction for the taxable year by reason of application of the preceding sentence, the disallowed amount shall be treated as an amount allowable as a deduction under subsection (c) for the following taxable year, subject to the application of the preceding sentence to such taxable year. For purposes of basis adjustments and determining whether cost depletion exceeds percentage depletion with respect to the production from a property, any amount disallowed as a deduction on the application of this paragraph shall be allocated to the respective properties from which the oil or gas was produced in proportion to the percentage depletion otherwise allowable to such properties under subsection (c).

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CHAPTER 2—TAX ON SELF-EMPLOYMENT INCOME

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SEC. 1402. DEFINITIONS.

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any trade or business carried on by a partnership of which he is a member; except that in computing such gross income and deductions and such distributive share of partnership ordinary income or loss—

(1) * * *

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(16) the deduction provided by section 199 shall not be allowed; [and]

(17) the deduction provided by section 200 shall not be allowed; and

[(17)] *(18)* notwithstanding the preceding provisions of this subsection, each spouse's share of income or loss from a qualified joint venture shall be taken into account as provided in section 761(f) in determining net earnings from self-employment of such spouse.

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DISSENTING VIEWS

THE SMALL BUSINESS TAX CUT ACT

We support policy initiatives to stimulate economic growth and job creation and believe a private-public partnership during this time of economic recovery is essential. Unfortunately, H.R. 9, the so-called Small Business Tax Cut Act, is a broad measure affecting 99.6 percent of all businesses that is not targeted at job creation. The benefits it provides will be meted out unevenly and in an arbitrary manner, accruing in large measure to the wealthiest taxpayers. While these facts alone argue for its rejection, this temporary and expensive provision is also the very antithesis of tax reform.

In their zeal to avoid picking "winners and losers," the majority has embraced a massive $46 billion tax cut that is being offered in the name of small business but will go to 99.6 percent of all businesses, whatever the value of their assets or the amount of their income and irrespective of the nature or function of their business. The tax break is available to partnerships of highly paid professionals, including lawyers and lobbyists. It is available to hedge fund and private equity fund managers. By restricting the definition of small business to an employee count and ignoring other relevant factors, such as revenues, H.R. 9 guarantees that the benefit will be available to a host of businesses that are anything but small. For example, many professional sports teams would get the tax break.

H.R. 9 is not targeted at job creation. Any number of measures could have been included in H.R. 9 to limit the availability of the tax benefit to businesses that hire or invest in the United States. None of these measures was included. There is no requirement that a business receiving the deduction created by H.R. 9 expand employment. In fact, a business that reduces employment remains eligible for the deduction. Even worse, businesses that reduce their American workforce while expanding overseas still get the tax break. In contrast to measures such as bonus depreciation or expensing, there is no requirement that a business receiving the tax break invest in the United States. And in contrast to measures such as infrastructure spending, this one-time tax cut for the very wealthiest would have a relatively small effect on cumulative economic output.

The benefit provided by H.R. 9 is arbitrary. In the case of small business owners, the same amount of small business income will not always produce the same benefit. Because the benefit is a deduction and not a credit, the value of the benefit increases with income. In addition, because the size of the benefit can be limited by a taxpayer's taxable income, losses that reduce or eliminate such

income, including losses carried forward from prior years, can eliminate the benefit.

Preliminary analyses indicate that H.R. 9 is a $46 billion tax cut disproportionately benefitting the very wealthiest Americans. Although a distributional analysis by the Joint Committee on Taxation is not yet available, the Center on Budget and Policy Priorities indicated that, based on an analysis provided by the Tax Policy Center, approximately "49 percent of the tax cut [provided by H.R. 9] would go to the 0.3 percent of people with incomes exceeding $1 million in 2012; they each would receive an average tax cut of more than $44,000." Middle- and low-income families are struggling to recover from the deepest recession in decades; they have lost jobs, homes and retirement security. The Republican Majority for months resisted extending the payroll tax cut benefitting these families. But now, the Majority is rushing to put forward another tax break for the very wealthiest Americans.

Given that this Committee has spent the last year and three months talking about tax reform, perhaps the most striking thing about H.R. 9 is that it is the antithesis of tax reform. The House Republican budget assumes that this Committee will produce a tax reform package with two rate brackets, but it offers no clear indication of how to finance rate reductions that would cost trillions of dollars. The only hint we have gotten is the vague promise of the House Budget Committee chairman to eliminate what he calls "tax loopholes." But to raise sufficient funds for his tax reform plans, his definition of "tax loophole" would have to include provisions related to health, education, home mortgage interest, and pensions. These are not "loopholes." Rather, in many cases, they are provisions designed to achieve clear economic and social policy goals. Ironically, H.R. 9 would be a new tax expenditure and a temporary one at that. And it would have far less merit than policies, such as the mortgage interest deduction and the exclusion for employer-provided healthcare, that now appear to be in the majority's crosshairs.

Finally, H.R. 9 is little more than a political device designed to give the majority a talking point for the week of April 15th. It is a distraction from the real businesses that should be before the Committee, including the continuing employment crisis and the need to address expiring provisions such as the AMT patch and other tax provisions critical to American businesses.

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