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Folder Title:
Digital Divide Issues

Stack:	Row:	Section:	Shelf:	Position:
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October 5, 2000

MEMORANDUM FOR GENE SPERLING

FROM: TOM KALIL

RE: DIGITAL DIVIDE TAX INCENTIVES

Summary: We clearly need to determine what our priorities are on the various digital divide tax incentives. I would advocate the following approach:

1. Support the New Millennium Classroom Act, but see if there are any changes that Treasury needs for tax policy reasons. From a "digital divide" point of view, the Santorum/Lieberman version already includes schools, libraries, senior centers, and training centers that provide "employment, vocational and job-training services to individuals with barriers to employment."

2. Agree to the "broadband" bill that is currently in the Senate "new markets" bill.

3. Support the Weller/Lewis legislation that makes computers and home Internet access a nontaxable fringe, but see if we can get the Republicans to ask for this.

4. I am not enthusiastic about our current proposals, but Talisman has provided some options for improving them in his September 14th memo (attached).

I. New Millennium Classrooms Act

- The Roth bill just extends current law until 2003 but adds libraries to the list of eligible recipient. Current law provides an enhanced deduction which is equal to the lesser of (1) the basis of the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold, or (2) twice the basis of the donated property.

- The Santorum/Lieberman bill makes the following changes:

- 50 percent credit of the retail value of the donated equipment if the recipient is located in an empowerment zone, enterprise community, renewal community, Indian reservation, or low-income community

- Computer can be up to 3 years old, as opposed to 2 years old;

- Donation does not need to go to a school, but can go to a senior center, a public library, or an organization which provides employment, vocational and job-training services to individuals to barriers with employment; and

- Treasury Secretary may develop minimum technical standards for the computers (this is the fix that NEA wanted).

- The bill is now supported by NEA, National Association of Secondary School Principals, a number of high-tech trade associations, and POWER UP. Some education groups continue to oppose it. An earlier version of this passed 96-2 in the Senate.

- Cost: There is no revenue estimate for the Santorum/Lieberman version. An earlier version of the bill cost $260 million over 5 years.

Recommended position: I think we should support this, although we should determine how strongly Treasury feels about some of the issues they raised on tax policy grounds. In the Talisman memo to you, he states "we do not support the proposals to ... allow taxpayers to claim a credit in lieu of an enhanced deduction." I do not think there is anything we need to add to the Santorum/Lieberman version from a "digital divide" point of view.

II. Broadband Internet Access Act

- Designed to stimulate broadband investment, especially in low-income and rural areas. Provides a 5-year, two-tiered credit:

    - 10 percent credit for "current generation" broadband services to subscribers in rural and underserved areas;

    - 20 percent credit for "next generation" broadband services in rural, underserved, and any residential areas.

- "Current generation" is defined as being able to deliver 1.5 megabits/second to subscriber (current DSL, cable modem). "Next generation" is 22 megabits/second - would require technology that is not currently widely deployed. Underserved is any census tract in an EZ, EC, renewal community, or poverty rate > 30 percent.

- Cost is $1.4 billion over 10

- 52 Senators, supporters ranging from Helms to Wellstone, 78 House members. Strong rural support. Outside supporters include American Farm Bureau, Corning, Council of Chief State School Officers, Information Technology Industry Council, LULAC, U.S. Distance Learning Association, World Institute on Disabilities, etc.

Discussion of Treasury concerns (in Talisman memo to Sperling and Kalil)

1. Favors one kind of Internet technology over another:

Comment: Yes, but bill is technologically neutral - could be cable, fiber, wireless, etc. It does favor faster over slower.

2. Administratively difficult to figure out what portion of the equipment is helping rural/underserved areas.

Comment: This is a valid criticism, but companies will only get the credit proportional to the percentage of the targeted population that is served by the equipment.

3. Doesn't solve the fact that the service may not be affordable to low-income subscribers.

Comment: Yes, but does solve the access problem, which is especially important in rural areas.

Recommended position: I think we should support, particularly given the President's strong interest in doing something about the rural broadband problem.

III. Computer and Internet access

- John Lewis and Jerry Weller have introduced H.R. 4274, the "Digital Divide Access to Technology Act of 2000." It would allow employers to provide home computers and Internet access to their employees without these benefits being treated as taxable income to the employee.

- The DATA Act treats employer-provided Internet access and the first $1,260 of the value of a computer and peripheral equipment (e.g., software and printers) as tax-free fringe benefits to the employee.

- However, for the proposal to apply, employers must provide computers to substantially all employees working in the United States and employees can receive only one computer every 36 months.

- The 5-year cost is $1.5 billion, the 10-year cost is $4 billion.

- There are 142 House co-sponsors, from Dick Armey to Major Owens. There are more Republican co-sponsors than Democrats.

- The major industry backers are companies like American Airlines and Delta, which have already instituted these programs.

Treasury concerns

- Could be a slippery slope. If this passes, will employers argue that cell-phones should be a non-taxable fringe benefit?

- There would be "incidental personal benefits for many employees, as well as their family members." There are no "efficiency gains that could justify a tax preference for consumption of goods … through an employment based system."

Recommended position: I disagree with Treasury. If we want to make PCs and Internet access as universal as the telephone, I think that making it a non-taxable fringe benefit makes sense.

IV. Our original proposals

Computer donations:

- Our proposal would be covered by the Santorum/Lieberman proposal, since we just wanted to expand current law to cover libraries and CTCs.

Credit for sponsorship of qualified zone academies and technology centers:

- Our current proposal would allocate credits for $16 million in corporate sponsorship to each of the 31 existing Empowerment Zones and 10 proposed new Empowerment Zones and $4 million in corporate sponsorship for each of the more than 80 Enterprise Communities. In total, our proposal would help support up to nearly $1 billion in annual sponsorships to help improve schools and community technology centers.

- You had expressed concern that this was too limited. Talisman suggests following as possibilities:

- Giving states a certain allocation of credits;

- Restricting their use to schools with at least 35 percent school-lunch population;

- Expanding to "Renewal Communities."

Workplace literacy and computer training tax credit

- Our original proposal would provide targeted tax relief to encourage companies to provide basic computer training, workplace literacy, or other basic education for employees that lack the basic skills to succeed in the modern workplace. Companies would be allowed to take a 20 percent tax credit for up to $5,250 in annual expenses per employee. Eligible employees generally would not have received a high school degree or its equivalent.

- You had expressed concern that this was too limited. Treasury suggested two expansions:

- Expand eligibility to employees who are eligible for work opportunity tax credit or welfare-to-work credit (or had been during the last 5 years). WOTC includes welfare recipients, 18-24 year-old EZ/EC residents, voc-rehab referrals, etc.

- Clarify that training does not need to be for "basic, entry-level computer skills" but can be for any computer skills instruction with broad applicability.

- These two expansions would be helpful, but this is still a fairly limited bill. In FY99, there were a total of 440,000 welfare-to-work and work opportunity tax credit certifications.

No credit is allowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, (3) in connection with the adoption of a child of the taxpayer's spouse, (4) that are reimbursed under an employer adoption assistance program or otherwise, or (5) for a foreign adoption that is not finalized.

The credit is phased out ratably for taxpayers with modified AGI above $75,000, and is fully phased out at $115,000 of modified AGI. For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded from gross income under Code sections 911, 931, or 933.

Explanation of Provision

The bill extends the adoption credit for the adoption of non-special needs children for two years through December 31, 2003.

Effective Date

$32/10 yrs Beth Kauffman, Treasury

The provision is effective on the date of enactment.

4. Tax treatment of Alaska Native Settlement Trusts (sec. 174 of the bill and new secs. 646 and 6039H of the Code)

Present Law

An Alaska Native Settlement Corporation ("ANC") may establish a Settlement Trust ("Trust") under section 39 of the Alaska Native Claims Settlement Act ("ANCSA") [21] and transfer money or other property to such Trust for the benefit of beneficiaries who constitute all or a class of the shareholders of the ANC, to promote the health, education and welfare of the beneficiaries and preserve the heritage and culture of Alaska Natives.

With certain exceptions, once an ANC has made a conveyance to a Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgement, except with respect to the lawful debts and obligations of the Trust.

The Internal Revenue Service has indicated that contributions to a Trust constitute distributions to the beneficiary-shareholders at the time of the contribution and are treated as dividends to the extent of earnings and profits as provided under section 301 of the Code. The Trust and its beneficiaries are taxed in accordance with trust rules.

Explanation of Provision

An Alaska Native Corporation may establish a Trust under section 39 of ANCSA and if the Trust makes an election for its first taxable year ending after the date of enactment of the proposal,

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[21] 43 U.S.C. 1601 et. seq.

no amount will be included in the gross income of a beneficiary of such Trust by reason of a contribution to the Trust. In addition, unless the electing Trust fails to meet the transferability requirements of the provision, income of the Trust, whether accumulated or distributed, will be taxed only to the Trust (and not to beneficiaries) at the lowest individual tax rates of 15 percent for ordinary income (and the capital gains rate applicable to individuals subject to such 15 percent rate), rather than at the higher rates generally applicable to trusts or to higher tax bracket beneficiaries.

The earnings and profits of the ANC will not be reduced by the amount of contributions to the electing Trust at the time of the contributions. However, the ANC earnings and profits will be reduced (up to the amount of the contributions) as distributions are thereafter made by the electing Trust that would exceed the Trusts's total undistributed net income (less taxes paid) plus tax-exempt income for all prior years during which an election is in effect plus for the current year, computed under Subchapter J. In addition, such distributions that exceed such amounts are to be reported and taxed to beneficiaries as if distributed by the ANC in the year of the distribution by the electing Trust, and will be treated as dividends to beneficiaries to the extent the ANC then has current or accumulated earnings and profits.

The fiduciary of an electing Trust must report to the IRS, with the Trust tax return, the amount of distributions to each beneficiary, and the tax treatment to the beneficiary of such distributions under the provision (either as exempt from tax to the beneficiary, or as a distribution deemed made by the ANC). The electing Trust must also furnish such information to the ANC. In the case of distributions that are treated as if made by the ANC, as described above, the ANC must then report such amounts to the beneficiaries and must indicate whether they are dividends or not, in accordance with the earnings and profits of the ANC. The reporting thus required by an electing Trust will be in lieu of, and will satisfy, the reporting requirements of section 6034A (and such other reporting requirements as the Secretary of the Treasury may deem appropriate).

If the beneficial interests in the electing Trust or the shares of the ANC may be sold or exchanged to a person in a manner that would not be permitted under ANCSA if the interests were Settlement Common Stock (generally, to a person other than an Alaska Native), then all assets of the Trust that had not been distributed as of the beginning of that taxable year of the Trust are taxed to the extent they would be if they were distributed at that time. Thereafter, the Trust and its beneficiaries are generally subject to the rules of subchapter J and to the generally applicable trust income tax rates.

Effective Date

The provision is effective for taxable years of Settlement Trusts, their beneficiaries, and sponsoring Alaska Native Corporations ending after the date of enactment, and to contributions made to electing Settlement Trusts during such year and thereafter.

Received Time Oct. 4. 8:10AM

cc: Kalil
Kellogg

1155 21ST STREET, N.W., SUITE 300
WASHINGTON, D.C. 20036

October 17, 2000

Mr. Gene Sperling
Assistant to the President
& Director of the National Economic Council
The White House
Washington, DC 20500

RE: THE DIGITAL DIVIDE AND THE NEW MILLENNIUM CLASSROOMS ACT

Dear Mr. Sperling:

In the remaining days of the Congressional session, the Administration can lead the fight against the "digital divide" by working with Congress to pass the New Millennium Classrooms Act (S. 542/H.R. 2308). This legislation would positively affect children across the country by redirecting high quality technology such as Pentium I & II computers to our neediest schools and libraries, particularly those located in economically disadvantaged areas such as empowerment zones and enterprise communities. Additionally, by putting newer Pentium I & II computers in classrooms, we can create a critical secondary use for the older computers. The hardware from these computers can be used in school labs to train future IT workers how to repair, install, and maintain computer networks.

Just this week, the Department of Commerce issued *Falling Through the Net: Toward Digital Inclusion,* an update on American's access to technology. The Report confirms that although great strides have been made in increasing the access of American's to technology and the Internet, the digital divide remains in full force, particularly with regard to the computer ownership and Internet access of minorities and those with lower incomes. The report further points out that public access points such as schools and libraries continue to serve those without access at home. The New Millennium Classrooms Act directly addresses this by facilitating the donation of computers to schools and libraries, particularly those in lower income areas. The bill helps ensure that economically disadvantaged children have access to computers and can begin their academic lives without being disenfranchised from technology.

Specifically the New Millennium Classrooms Act would provide companies with an enhanced tax incentive for the donation of computer technology and peripheral equipment to schools located within designated empowerment zones, enterprise communities, and Indian reservations. It would further expand upon current law by allowing original equipment manufacturers donating reacquired computer equipment to qualify for the tax incentive. It would also increase the allowable age of a qualified computer donation from two years to three. The New Millennium Classrooms Act amends an existing provision of law that expires this year. The changes are needed to increase the donor base of companies able to donate high-quality computers.

The bipartisan bill has passed the Senate by a vote of 96 to 2. It also has 118 cosponsors in the House, including a majority of the Ways & Means Committee. As you continue to negotiate with Congress this year, we urge you to support this non-controversial legislation as part of the Community Renewal/New Markets bill or any other appropriate tax vehicle. Without your leadership in this important area, the digital divide will continue to grow as it has in recent years, leaving those most in need, furthest behind.

Sincerely,

American Library Association
Computers for Schools Association
Computing Technology Industry Association
Consumer Electronics Association
Goodwill Industries International, Inc.
Information Technology Association of America
National Association of Manufacturers
National Christina Foundation
National Education Association
Technology Workforce Coalition
US Chamber of Commerce

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COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE

cc: Kvaal
Kellogg
for response

Congress of the United States
House of Representatives
XAVIER BECERRA
30TH DISTRICT, CALIFORNIA

FAX COVER SHEET

DATE: 10/19/00

TO: Mr. Gene Sperling

FAX#: (202) 456-2878

FROM: Xavier Becerra

NO. PAGES (including cover sheet): 6

COMMENTS:

Gene,

Good talking to you.
Here's information on the New Millenium Classrooms Act, the READ Act, and the non-profit thrift parity language. Debra Dixon, in my office, is available to you or your staff for any questions that may arise.

Xavier Thanks!

The New Millennium Classrooms Act
H.R. 2308

Legislative Proposal

The *New Millennium Classrooms Act*, H.R. 2308, builds upon changes made to the tax code in 1997 in order to increase the number of computers donated to schools. Specifically, the bill strengthens current law in the following manner: (i) it extends the age of the computer equipment eligible for the tax deduction from two to three years; (ii) it expands the allowable donor base of computer equipment to include original equipment manufacturers (OEMs) or any reacquirer of the computer equipment; (iii) it allows a tax credit equal to 30% of the retail value of the donated computer equipment with a 50% tax credit if the donation is a qualified enterprise zone or empowerment zone donation; and (iv) it makes public libraries eligible for the credit.

The *New Millennium Classrooms Act* was introduced in the House by Congressmen Portman and Becerra on June 22, 1999. It currently has over 100 co-sponsors and enjoys broad bi-partisan support. A companion measure was introduced in the Senate by Senators Abraham and Wyden as S. 542 and has passed the Senate twice, most recently by a margin of 96 to 2. The Joint Committee on Taxation estimates that the bill would cost the U.S. government $262 million over 5 years.

Legislative Background

The *Taxpayer Relief Act of 1997* included a provision known as "The 21st Century Classroom Act" which was designed to encourage the private donation of computers to elementary and secondary schools in order to reduce the cost of making U.S. schools technologically effective for students.

The provision which added section 170(e)(6) to the Internal Revenue Code provided that contributions of computer equipment by corporations to eligible schools could qualify for an augmented deduction similar to that available for the contribution of inventory property for the care of the aged or some scientific equipment used for research. The provision will sunset in 2001.

Section 170(e)(6) restricts eligible contributions to PCs no older than two years of age. The deduction allowed is limited to the donor's "basis" in the property, plus one-half of the amount of ordinary income that would have been realized had the property been sold. The CBO estimated that the provision would reduce Federal fiscal year budget receipts by $46 million in 1998, $48 million in

1999, $77 million in 2000, $49 million in 2001, $5 million in 2002, and $1 million in 2003.

Eliminating the Digital Divide

Unfortunately, due to various factors, most companies choose not to take advantage of IRC Section 170(e)(6) and as a result, our students do not have the type of access to computer equipment necessary to prepare them to compete in the marketplace. It is estimated that starting this year, 60% of all jobs will require high-tech skills. Currently, there are close to 200,000 unfilled jobs in the computer industry alone -- a field expected to generate more than a million new jobs by 2006. The New Millennium Classrooms Act strengthens present law in order to ensure that more computers flow into our classrooms and libraries.

Experience has taught us that the current law, two-year limit, does not sufficiently increase the donation of computers. Most businesses use their computers for approximately 5 years before purchasing new equipment while the average age of computers in schools now is 7 years. Consequently, changing the limit to 3 years will create a larger donor pool of computers. Even if all the computers that were donated were 3 years old, this bill has the potential to cut the age of computers in schools by more than half.

At the time the original bill was passed, three-year-old computers did not necessarily have the technical capabilities required to connect successfully to the Internet or run educational software. However, a three-year-old computer today has Pentium I or Pentium II multi-media capabilities and therefore, no such problem arises in today's computers. It is worth noting that the bill does not preclude the donation of new computers. The technology decision-making power remains in the hands of the teacher. Schools will have the freedom to accept only donations that fit into their overall technology needs. Moreover, in order to guarantee that every computer meets certain requirements, the legislation includes language that sets technological standards for every donation.

H.R. 2308 also provides greater incentive for the donation of computers to schools and libraries located in empowerment/enterprise zones. The ratio of multimedia computers to students in these areas is much higher than the 1 to 5 ratio recommended by the Department of Education. Schools with 81% or more economically disadvantaged students only have one computer for every 32 students. We cannot have an educated populace if we leave a portion of the country behind. The *New Millennium Classrooms Act* provides schools with a stronger tool in preparing students to compete in an increasingly technology-oriented economy.

Reading Enrichment After-School Development Act (READ)

H.R. 4947

Legislative Background

- Twenty-first Century Community Learning Centers (21st CCLC), authorized by Title X, Part I, as amended, of the Elementary and Secondary Education Act, are after school, weekend, and summer programs that are set up by public schools or consortia of public schools.

- The 21st CCLC program was authorized for 5 years, FY 1995-1999. In FY 1995, $750,000 was appropriated for the program; by FY 1999, $200 million was appropriated for the program. The administration has requested $1 billion in funding for FY 2001.

- About 3,600 rural and inner-city public schools in 903 communities--in collaboration with other public and non-profit agencies, organizations, local businesses, post-secondary institutions, scientific/cultural and other community entities--are now participating as 21st Century CLCs.

- However, each weekday afternoon, at least 8 million "latchkey" children are left alone and unsupervised. The need for after-school programs in a safe environment continues to outgrow the number of students.

Legislative Proposal

- The *Reading Enrichment After-School Development Act*, crafted in collaboration with the Council of Great City Schools and the American Library Association, builds upon the 21st Century Community Learning Center program language by adding a provision which allows public libraries, in partnership with schools, to qualify for 21st CCLC grants.

- The *Reading Enrichment After-School Development Act* also builds upon existing programs by allowing public libraries to house 21st Century Community Learning Centers, whereas current law restricts those sights to schools.

- The *Reading Enrichment After-School Development Act* was introduced by Congressman Xavier Becerra on July 25, 2000.

PROVISION TO ENSURE TAX PARITY FOR NON-PROFIT THRIFTS

CURRENT LAW

- Last year H.R. 10, the Credit Union Membership Act, expanded the potential membership and deposit base for non-profit credit unions while at the same time maintaining their tax-exempt status.

- However, state chartered, FDIC-insured industrial thrifts (as defined by §2(c)(2)(H) of the Bank Holding Company Act) that are controlled by non-profit organizations continue to be taxed on their earnings.

- Only one such institution exists--the East Lost Angeles Community Union (TELACU). TELACU, a community development corporation, has brought thousands of jobs and affordable housing units to lower income areas of Los Angeles.

- TELACU has achieved its goals through a number of vehicles, including the Community Commerce Bank, which primarily lends to consumers and businesses located in East and South Central Los Angeles. Earnings from the bank are then reinvested by TELACU into other job creating activities.

- Despite the fact that the Community Commerce Bank is controlled by a non-profit entity, current law requires the thrift to pay taxes on its earnings, thus reducing the monies available for community revitalization by forty percent.

- Unfortunately, current law makes it impracticable for the Community Commerce Bank to reorganize as a credit union. As a credit union, the thrift would be forced to answer to its membership and would thus be unable to direct its profits to TELACU's community investment activities.

LEGISLATIVE PROPOSAL

- The attached language would allow state chartered, FDIC-insured industrial thrifts the same tax treatment afforded to non-profit federal credit unions under the Credit Union Membership Act.

REVENUE ESTIMATE

- This provision would result in a revenue loss of approximately $1 million a year.

Amendment

At the appropriate place insert:

"A financial institution which is excluded from the definition of "bank" in 12 U.S.C. 1841(c)(2)(H) and which is owned by a subsidiary of a not-for-profit corporation shall, for the purposes of Sec. 122 of the Federal Credit Union Act (12 U.S.C. 1768) only, be treated as a Federal credit union."

DEPARTMENT OF THE TREASURY
WASHINGTON

September 14, 2000

ASSISTANT SECRETARY

MEMORANDUM FOR GENE SPERLING
TOM KALIL

FROM: JONATHAN TALISMAN
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Possible "Digital Divide" Tax Incentives

The following summarizes our views on the "digital divide" tax proposals that you asked us to review in your prior memo. I apologize for the delay in responding to your request.

(1) Corporate donations of computers – expansion of Administration proposal.—We support a temporary extension and expansion of current-law section 170(e)(6), as proposed in the President's FY 2001 budget, through June 30, 2004 (when the R&E credit is scheduled to expire). Even so, we oppose the New Millennium Classroom Act (H.R. 2308 and S. 542) as introduced. However, there are some features of the congressional proposals that we could support building into the President's proposals. As part of a temporary extension of section 170(e)(6), we could support the following proposals:

(a) providing that the enhanced deduction under section 170(e)(6) could be claimed for computers that are up to three years old (starting from the date of manufacture or acquisition by the taxpayer, but not allowing the "clock to be restarted" by re-acquisition of a computer by the donor), provided that – as proposed by NEA – the donated computers meet the minimum standards prescribed by Treasury, which would reflect the mid-point performance standard of industry sales for three-year-old computers);

(b) allowing the enhanced deduction under section 170(e)(6) to be claimed by a corporate donor which re-acquires a computer which it previously sold to a customer (i.e., in the case of a re-acquisition, the original use of the donated computer need not be by the donor or the donee), provided that the computer is not more than three years old on the date of donation;

(c) expanding eligible donors under sections 170(e)(3), (e)(4), and (e)(6) to include all taxpayers (not merely C corps as under current law), but limit the enhanced deduction to 10% of business income (consistent with the current-law rule for C corps);

(d) expanding the class of eligible donees under section 170(e)(6) to include not only public libraries and community technology centers located in low-income communities (as under the President's FY 2001 budget) but also any charity, no matter where located, that is organized and operated primarily for purposes of providing computers without charge to lower-income families (as proposed by Mr. Jefferson in H.R. 4061); and

(e) clarifying that, in cases where a business taxpayer's adjusted basis in property of any kind (not merely computers) exceeds the property's fair market value, the taxpayer may abandon the property for purposes of section 165 (and thereby claim an abandonment loss equal to the property's adjusted basis) by giving the property to charity. In some cases, current law is not clear whether a business taxpayer is entitled to claim a higher deduction by throwing away used property than by donating it to charity.

We do not support the proposals to increase the amount of the enhanced deduction allowed under section 170(e)(6) or to allow taxpayers to claim a credit in lieu of an enhanced deduction. It would set a bad precedent to allow taxpayers to claim a charitable contribution deduction for unrecognized, built-in ordinary income beyond that allowed by the current-law rules. Moreover, although we have examined a proposal to repeal the "twice basis" limitation of section 170(e)(6), we understand that this limitation rarely comes into play with donations of computers (most of which have a high basis relative to the property's fair market value.

(2) Workplace literacy and computer training tax credit—expansion of Administration proposal.—We continue to oppose the congressional "IT Training Credit" proposal from last year (which would provide a credit for virtually all employer-provided technology training expenses that would be incurred in any event). However, we support expansion of the Administration's proposed 20% workplace literacy and technology training credit, so that the credit would be available not only for training expenses incurred for employees who lack a high school degree – as originally proposed – but also for training of employees who are (or had been during the last five years) eligible employees for purposes of the work opportunity tax credit or the welfare-to-work credit. We do not, however, think it is appropriate to provide a special credit for technology training provided to all low-wage employees, because defining "low-wage employees" in a way that the IRS could enforce would be very difficult, especially in the case of part-time workers.

You suggest clarifying the Administration's proposal so that it includes not only basic computer skills but "the kind of skills identified in the Conrad [IT Training] bill." We believe that all computer skills training for eligible employees generally would be covered by the Administration's proposal, provided that computer skills instruction is of "broad applicability." We could, however, modify the Administration's proposal so that, as long as the computer training is provided to an eligible employee and the training is of broad applicability (as opposed to being for a particular vendor's product), there would be no need to inquire as to whether the computer training was for "basic, entry-level computer skills" or for more advanced computer skills.

(3) Credit for sponsorship of qualified zone academies and technology centers.—The current Administration proposal provides for an allocated credit, which would be allocated for each designated empowerment zone and enterprise community by the local governmental agency

with responsibility for implementing the strategic plan that the area was required to agree to as part of the empowerment zone (or enterprise community) designation process. If we wanted this proposed credit also to be available for sponsorship of public schools or technology centers outside of designated empowerment zones or enterprise communities, we could also authorize the State's department of education (or any other agency designated by each State's governor) to make allocations of credits for up to $X of sponsorship payments to any K-12 public school or nonprofit community technology center located anywhere in the State (or perhaps anywhere in the State outside of an empowerment zone or enterprise community, which would continue to receive a separate credit allocation).

If a separate State-wide allocation were to be provided for, we would have to decide whether the State-wide allocation should vary based on each State's total population (or their respective populations below the poverty line, as with the current-law QZAB allocation regime, see sec. 1397E(e)(2)), and whether any adjustment should be made based on the number of designated empowerment zones or enterprise communities in each State.

With respect to this particular expansion of the Administration's proposal, we recently spoke to staff of Mr. Rangel, who was the original sponsor of this proposal. Mr. Rangel's staff suggested that a statewide allocation be limited so that it could be used only for corporate sponsorship of public schools that are eligible for QZABs (i.e., at least 35 percent of students are eligible for subsidized lunches). Mr. Rangel's office is concerned that, if there is a limited amount of corporate sponsorship money available, an expansion of the proposal to all public schools could decrease the likelihood that needier schools will receive corporate sponsorship payments. In addition, we may need to consider whether the proposal should be expanded to the so-called "Renewal Communities," which are to be designated under the New Markets agreement reached by the President and Speaker Hastert.

Employer-provided computers and internet access.—We are concerned about the precedent of providing tax-free treatment for employer provided computers, as proposed by the Digital Divide Access to Technology Act of 2000 (H.R. 4274), which was introduced by Jerry Weller and John Lewis on April 13, 2000. There would be more than incidental personal benefits for many employees, as well as their family members, under such an employer-provided program, yet (as discussed further below) there are no efficiency gains that could justify a tax preference for consumption of goods such as computers through an employer-based system.

Although there is some uncertainty regarding the tax treatment under current-law rules of employer-provided computers and internet access in certain situations, a preliminary estimate by Joint Committee is that H.R. 4274 would cost approximately $1.5 billion over the five-year budget window, which exceeds the cost of the Administration's entire "digital divide" package in its FY 2001 budget.

H.R. 4274 would provide tax-free treatment for employer-provided computers (with certain dollar caps) and internet access (without any dollar cap) for use by an employee and anyone else who resides in the employee's home. Proponents of the bill argue that it would simplify tax administration, by eliminating the necessity under current law to determine on an employee-by-employee basis whether an employer-provided computer and/or internet access is a non-taxable fringe benefit because it is sufficiently related to each employee's current job position. (This current-law test is most easily met by professionals, who also tend to have higher incomes.) Moreover, proponents argue that the proposal could be viewed as an expansion of section 127 to promote computer literacy. Currently, section 127 allows employers to provide tax-free educational assistance (including payments for tuition, equipment, and supplies) to their employees, but section 127 does not apply to "tools and supplies which may be retained by the employee after completion of a course of instruction."

However, in the case of employer-provided computers, there may not be any formal course of instruction for the employee, even though the item being provided by the employer has obvious personal/recreational uses. For example, Ford Motor Company plans on allowing all 350,000 of its employees to lease a home computer from Ford (and be provided internet access at home) for $5 per month, without regard to the whether the employee already is computer literate or whether he/she uses the computer solely for personal reasons or as part of a structured educational program. Industry representatives claim that there would be efficiency gains because rank-and-file workers will be using computerized equipment more and more over time, so using a computer at home would improve their skills at work. But there is no evidence that employees will acquire significant job skills from having a computer and internet access at home. Indeed, there is no guarantee that employees (as opposed to others in the household) will even use their home computers. Ford says that their unions have rejected any requirement that employees use their home computers for any work-related purposes, such as reading email messages. Thus, there is no evidence for an efficiency gain from mere access to home computers or the internet that could justify a tax preference, in contrast to other employer-provided fringe benefits such as health insurance or retirement benefits.

Putting aside for the moment the general issue of whether we support H.R. 4274, your memo suggests modifications to the introduced bill. Specifically, you suggest that H.R. 4274 be modified to explicitly include employer-provided broadband Internet access and that the tax-free treatment under the bill be increased from $35 to $60 per month to cover both broadband Internet access plus computer rental. We do not think that these suggested modifications to H.R. 4274 are necessary. First, the introduced bill already covers employer-provided Internet access, regardless of whether such access is "broadband" or not, so long as the Internet access is "made available to substantially all employees of the employer on substantially the same basis" (other than part-time or seasonal employees or those who work outside the U.S.). Second, the $35 per-month cap contained in the introduced bill does not apply to Internet access of any kind, but rather applies only to the rental value of the computer itself when ownership is not transferred to the employee. (Under the introduced bill, when ownership of the computer is transferred to the employee, the exclusion per employee is limited to an aggregate amount of $1,260 every three years.) The introduced bill contains no dollar cap on the value of employer-provided Internet access, so there is no need to take into account that broadband internet access is more expensive.

You also suggest that H.R. 4274 be modified to cover arrangements under which an employer leases a computer (which is then loaned to an employee) rather than transferring ownership of the computer to the employee. Again, such a modification is not necessary, because the introduced bill already provides for such arrangements.

(5) Computer purchases by EITC recipients.—We oppose Rep. Jefferson's proposal (which is part of H.R. 4061) to allow individuals who are eligible to claim the EITC for a taxable year to also claim a $500 refundable tax credit for 50-percent of the costs they incur to purchase computer equipment or software capable of providing Internet access. Although narrowly targeted in terms of the taxpayers eligible to claim the new credit, the proposal would raise serious policy and administrative concerns. First, the proposed tax credit would be of little help to the lowest income households, because the refundable credit would not be received until after a tax return is filed after the year in which the computer must be purchased. Second, it would be difficult for the IRS to verify whether a taxpayer's claim of the credit is valid, without imposing significant reporting burdens on businesses that sell computers and software. Further, even if an information reporting system were established, it would be difficult for the IRS to ensure that qualifying individuals did not use the credit to purchase computers that they would then sell to non-qualifying persons. Finally, under the introduced bill, taxpayers could repeatedly claim a credit year after year (e.g., by claiming to purchase a computer one year, a new printer the next, and then software or an equipment upgrade after that). In view of these problems, Treasury believes that a better approach is to expand the EITC as proposed in the President's FY 2001 budget, which would provide low-income working families with additional resources (through advance payments made by the employer) that could be used not only for computers, but also other educational expenses, or other essentials, such as housing and child care.

(6) Broadband access.—We generally oppose the broadband investment tax credit proposals (both S. 2321 and the draft Moynihan proposal). These proposals would provide a tax credit for investment in broadband equipment, both to serve certain under-served geographic areas and to provide an incentive for investment in more advanced broadband technology regardless of the geographic areas to be served. As discussed in a more detailed memo previously sent to you, we do not think that it is appropriate to provide a preference for one type of Internet technology over other technologies. Moreover, the proposals would raise difficult administrative problems in trying to determine what portion of investment actually provides Internet access to persons residing in poor urban or rural areas, as opposed to the equipment, although located in a targeted geographic area, providing access to persons to located outside the targeted area. Moreover, the proposal would not help with the more fundamental problem that many persons located in poor urban and rural areas cannot afford Internet access.

(7) Teacher training.—We oppose legislation (H.R. 1075) that would increase the current-law Lifetime Learning credit rate to 50 percent, but only for elementary and secondary school teachers who incur out-of-pocket expenses to enroll in courses in which they receive "instruction on basic or advanced computer functions or computer software (including educational software offered by a single institution) approved for such individual by such local educational agency," provided that such the expenses are incurred "for the purposes of integrating materials covered by such course into the courses taught in the elementary or secondary classroom." This proposal would further complicate the already complex Hope

and Lifetime Learning credits, and would raise definitional issues and compliance problems in attempting to verify whether the technology training from a particular course was intended to be integrated into the teacher's curriculum. Under current law, expenses incurred for technology training at a post-secondary institution are eligible for the Lifetime Learning credit, which the Administration proposes to increase to 28% for all students and courses.

We also oppose H.R. 1076, which would allow elementary and secondary school teachers to claim a 100% credit (up to $2,000 lifetime cap) for costs incurred to purchase a computer, related peripheral equipment, or software (other than software primarily used for entertainment). This proposal raises numerous compliance problems.

October 5, 2000

MEMORANDUM FOR GENE SPERLING

FROM: TOM KALIL

RE: DIGITAL DIVIDE TAX INCENTIVES

Summary: We clearly need to determine what our priorities are on the various digital divide tax incentives. I would advocate the following approach:

1. Support the New Millennium Classroom Act, but see if there are any changes that Treasury needs for tax policy reasons. From a "digital divide" point of view, the Santorum/Lieberman version already includes schools, libraries, senior centers, and training centers that provide "employment, vocational and job-training services to individuals with barriers to employment."

2. Agree to the "broadband" bill that is currently in the Senate "new markets" bill.

3. Support the Weller/Lewis legislation that makes computers and home Internet access a nontaxable fringe, but see if we can get the Republicans to ask for this.

4. I am not enthusiastic about our current proposals, but Talisman has provided some options for improving them in his September 14th memo (attached).

I. New Millennium Classrooms Act

- The Roth bill just extends current law until 2003 but adds libraries to the list of eligible recipient. Current law provides an enhanced deduction which is equal to the lesser of (1) the basis of the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold, or (2) twice the basis of the donated property.

- The Santorum/Lieberman bill makes the following changes:

- 50 percent credit of the retail value of the donated equipment if the recipient is located in an empowerment zone, enterprise community, renewal community, Indian reservation, or low-income community

- Computer can be up to 3 years old, as opposed to 2 years old;

- Donation does not need to go to a school, but can go to a senior center, a public library, or an organization which provides employment, vocational and job-training services to individuals to barriers with employment; and

- Treasury Secretary may develop minimum technical standards for the computers (this is the fix that NEA wanted).

- The bill is now supported by NEA, National Association of Secondary School Principals, a number of high-tech trade associations, and POWER UP. Some education groups continue to oppose it. An earlier version of this passed 96-2 in the Senate.

- Cost: There is no revenue estimate for the Santorum/Lieberman version. An earlier version of the bill cost $260 million over 5 years.

Recommended position: I think we should support this, although we should determine how strongly Treasury feels about some of the issues they raised on tax policy grounds. In the Talisman memo to you, he states "we do not support the proposals to … allow taxpayers to claim a credit in lieu of an enhanced deduction." I do not think there is anything we need to add to the Santorum/Lieberman version from a "digital divide" point of view.

II. Broadband Internet Access Act

- Designed to stimulate broadband investment, especially in low-income and rural areas. Provides a 5-year, two-tiered credit:

    - 10 percent credit for "current generation" broadband services to subscribers in rural and underserved areas;

    - 20 percent credit for "next generation" broadband services in rural, underserved, and any residential areas.

- "Current generation" is defined as being able to deliver 1.5 megabits/second to subscriber (current DSL, cable modem). "Next generation" is 22 megabits/second - would require technology that is not currently widely deployed. Underserved is any census tract in an EZ, EC, renewal community, or poverty rate > 30 percent.

- Cost is $1.4 billion over 10

- 52 Senators, supporters ranging from Helms to Wellstone, 78 House members. Strong rural support. Outside supporters include American Farm Bureau, Corning, Council of Chief State School Officers, Information Technology Industry Council, LULAC, U.S. Distance Learning Association, World Institute on Disabilities, etc.

Discussion of Treasury concerns (in Talisman memo to Sperling and Kalil)

1. Favors one kind of Internet technology over another:

Comment: Yes, but bill is technologically neutral - could be cable, fiber, wireless, etc. It does favor faster over slower.

2. Administratively difficult to figure out what portion of the equipment is helping rural/underserved areas.

Comment: This is a valid criticism, but companies will only get the credit proportional to the percentage of the targeted population that is served by the equipment.

3. Doesn't solve the fact that the service may not be affordable to low-income subscribers.

Comment: Yes, but does solve the access problem, which is especially important in rural areas.

Recommended position: I think we should support, particularly given the President's strong interest in doing something about the rural broadband problem.

III. Computer and Internet access

- John Lewis and Jerry Weller have introduced H.R. 4274, the "Digital Divide Access to Technology Act of 2000." It would allow employers to provide home computers and Internet access to their employees without these benefits being treated as taxable income to the employee.

- The DATA Act treats employer-provided Internet access and the first $1,260 of the value of a computer and peripheral equipment (e.g., software and printers) as tax-free fringe benefits to the employee.

- However, for the proposal to apply, employers must provide computers to substantially all employees working in the United States and employees can receive only one computer every 36 months.

- The 5-year cost is $1.5 billion, the 10-year cost is $4 billion.

- There are 142 House co-sponsors, from Dick Armey to Major Owens. There are more Republican co-sponsors than Democrats.

- The major industry backers are companies like American Airlines and Delta, which have already instituted these programs.

Treasury concerns

- Could be a slippery slope. If this passes, will employers argue that cell-phones should be a non-taxable fringe benefit?

- There would be "incidental personal benefits for many employees, as well as their family members." There are no "efficiency gains that could justify a tax preference for consumption of goods … through an employment based system."

Recommended position: I disagree with Treasury. If we want to make PCs and Internet access as universal as the telephone, I think that making it a non-taxable fringe benefit makes sense.

IV. Our original proposals

Computer donations:

- Our proposal would be covered by the Santorum/Lieberman proposal, since we just wanted to expand current law to cover libraries and CTCs.

Credit for sponsorship of qualified zone academies and technology centers:

- Our current proposal would allocate credits for $16 million in corporate sponsorship to each of the 31 existing Empowerment Zones and 10 proposed new Empowerment Zones and $4 million in corporate sponsorship for each of the more than 80 Enterprise Communities. In total, our proposal would help support up to nearly $1 billion in annual sponsorships to help improve schools and community technology centers.

- You had expressed concern that this was too limited. Talisman suggests following as possibilities:

- Giving states a certain allocation of credits;

- Restricting their use to schools with at least 35 percent school-lunch population;

- Expanding to "Renewal Communities."

Workplace literacy and computer training tax credit

- Our original proposal would provide targeted tax relief to encourage companies to provide basic computer training, workplace literacy, or other basic education for employees that lack the basic skills to succeed in the modern workplace. Companies would be allowed to take a 20 percent tax credit for up to $5,250 in annual expenses per employee. Eligible employees generally would not have received a high school degree or its equivalent.

- You had expressed concern that this was too limited. Treasury suggested two expansions:

- Expand eligibility to employees who are eligible for work opportunity tax credit or welfare-to-work credit (or had been during the last 5 years). WOTC includes welfare recipients, 18-24 year-old EZ/EC residents, voc-rehab referrals, etc.

- Clarify that training does not need to be for "basic, entry-level computer skills" but can be for any computer skills instruction with broad applicability.

- These two expansions would be helpful, but this is still a fairly limited bill. In FY99, there were a total of 440,000 welfare-to-work and work opportunity tax credit certifications.